

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

ANNUAL COMPLIANCE REVIEW, 2016

Docket No. ACR2016

UNITED STATES POSTAL SERVICE
FY 2016 ANNUAL COMPLIANCE REPORT
(December 29, 2016)

The United States Postal Service hereby submits its Fiscal Year 2016 Annual Compliance Report (ACR or Report). The Report is submitted pursuant to 39 U.S.C. § 3652, which requires the Postal Service to file with the Postal Regulatory Commission, within 90 days after the end of each fiscal year (FY), a variety of data on “costs, revenues, rates, and quality of service,” in order to “demonstrate that all products during such year complied with all applicable requirements of [title 39].”¹

¹ Unless specified otherwise, section numbers used herein refer to statutory provisions in title 39, United States Code.

I. OVERVIEW OF REPORT

A Contents

This Report consists of both the present document and underlying data appended as 73 separate folders. The present document contains only the most salient information from those folders, in order to demonstrate compliance with title 39. The reader should refer to the appended folders for more detailed information. A list of the appended folders appears at the end of this document at Attachment One.² Each folder includes a preface document explaining its purpose, background, structure, and relationship with other materials in the Report.

Broadly speaking, there are three types of data in the appended folders: (1) product costing material; (2) intra-product cost analyses; and (3) billing determinants. The focus of the product costing material, in terms of ultimate output, is the Cost and Revenue Analysis (CRA) report, at USPS-FY16-1, and the International Cost and Revenue Analysis (ICRA) report, at USPS-FY16-NP2. The intra-product cost analyses make possible the examination of workshare discounts presented in Section II below. The billing determinants set forth the volume and calculated revenue for each rate cell of every mail product.

As in previous ACRs, certain materials are presented in two versions, one public and the other nonpublic. The public versions of these materials are limited to information on individual market dominant products, and aggregate information on either competitive products as a whole or large groups of competitive products.

² The folders are sequentially numbered and labeled as USPS-FY16-1, USPS-FY16-2, etc. Folders in the nonpublic annex, discussed in Section VI below, are labeled as USPS-FY16-NP1, USPS-FY16-NP2, etc. (with “NP” signifying “nonpublic”).

Correspondingly, the nonpublic versions contain either disaggregated information on competitive products or information on both market dominant and competitive products in contexts in which it is not possible to segregate the two. This is discussed further in Section VI below.

Section 3652(g) of title 39 requires the Postal Service to submit, together with this Report, a copy of its most recent Comprehensive Statement. A copy of the Postal Service's FY 2016 Comprehensive Statement appears within the FY 2016 Annual Report provided as USPS-FY16-17. Similarly, a copy of the Postal Service's annual report to the Secretary of the Treasury regarding the Competitive Products Fund, required by section 2012(i) of title 39, appears as part of USPS-FY16-39, along with the other Competitive Products Fund materials required by Commission Rules 3060.20 through 3060.23.

B. Roadmap

A separate roadmap document is included at USPS-FY16-9. The roadmap is a technical document that consolidates brief descriptions of each of the appended folders and of the flow of inputs and outputs among them. It also discusses any changes between the methodologies used to prepare this Report and the methodologies applied by the Commission in the FY 2015 Annual Compliance Determination (ACD). In addition, it includes the listing of special studies and the discussion of obsolescence required by Commission Rule 3050.12.

C. Methodology

The methodologies employed are in general also quite familiar to the Commission and parties that have historically been involved in postal ratemaking.

Because heavy reliance is placed on replicating the methodologies used most recently by the Commission, the scope of new methodologies has been minimized. Postal operations and postal data collection are not entirely static, however, and consequently some minor changes in methodology are identified and discussed. This is done in two places. First, methodology changes are identified in a separate section of the roadmap document, USPS-FY16-9. Second, they are discussed in the preface accompanying each of the appended materials; often, this preface contains a discussion that is more detailed than that contained in the roadmap document. Thus, if a change relates to an area of particular interest to the reader, it may be useful to refer to the particular folder in question, rather than relying exclusively on the roadmap document. The basic costing methodologies applied are those most recently employed by the Commission.

On the subject of methodological changes, however, a potentially noteworthy development in FY 2016 regarding the product costs discussed in the Annual Compliance Report was the issuance of Order No. 3506. Pursuant to that Order, issued by the Commission in Docket No. RM2016-2 on September 9, 2016 (and revised October 19, 2016), the calculation of attributable costs will be changing. In prior years, the attributable costs of a product were the sum of its volume variable and product specific costs. Going forward, the attributable costs of a product will be the sum of its volume variable and product specific costs, plus the product's inframarginal costs developed as part of the estimation of the product's incremental costs. Thus, in theory, the attributable costs of each individual product reported in the Cost and Revenue Analysis (CRA) Report will computationally match the incremental costs of the same product.

Unfortunately, in reality, there are several circumstances that complicate achievement of that theoretical congruence, and which have thus precluded incorporation of the new inframarginal cost component into the CRA Report this year. One such circumstance has already been acknowledged by the Commission, and occurs in instances in which computational limitations preclude separate estimation of incremental costs (and thus inframarginal costs) for certain products, most notably international mail products. See, Order No. 3641 (December 1, 2016) at 6. Until those limitations can be surmounted, the attributable costs reported for those products in the CRA Report (and ICRA Report) have to continue to be calculated as the volume variable plus product specific costs.

Another difficulty is encountered when the volume variable costs for a product are altered by a final adjustment that takes place (e.g., in the D Report) *after* the volume variable costs are input (from the C Report) into the estimation of incremental costs. Note that the circumstances which cause a situation to have to be handled by a final adjustment (normally the lack of data at a cost pool level) also preclude using the adjusted volume variable costs as the inputs into the incremental cost estimation model. In those instances, under current procedures, the incremental costs coming out of the model can only reflect the sum of the *non-adjusted* volume variable costs and the resulting inframarginal costs (plus any product specific costs). A potentially suitable adjustment in these circumstances can perhaps be constructed by adding the

inframarginal costs from the incremental cost model to the *adjusted* volume variable costs (plus any product specific costs).³

A third set of circumstances presents a more intractable problem. Since implementation of the PAEA classification regime, the Commission treats each Negotiated Service Agreement (NSA) as a separate product. See, e.g., Docket No. RM2007-1, Order No. 25 (August 15, 2007) at 56, 82; Order No. 43 (October 29, 2007) at 99. Yet the Postal Service's costing data systems cannot distinguish mail pieces at the cost pool level based on whether they are entered pursuant to an NSA or not. Therefore, when calculating incremental costs for a "product type" such as Priority Mail, the incremental cost model can only estimate incremental costs for the totality of the "product type," and can distinguish neither among NSA products, nor between NSA and non-NSA mail. As a consequence, the current structure of the CRA Report, which in these circumstances shows costs in two rows (one row for aggregate NSA mail within the "product type", and one row of non-NSA mail), cannot accommodate a single unified estimate of the incremental (and thus inframarginal) costs of the "product type."⁴

Equally importantly, with existing data, meaningful estimates of inframarginal costs

³ For example, a final adjustment in the D Report shifts certain volume variable costs between High Density and Saturation Letters and High Density and Saturation Flats and Parcels. Correctly calculating the incremental costs of those two products would require the development of inframarginal costs *after* taking those cost shifts into account. But an acceptable proxy may be to combine unadjusted inframarginal costs (i.e., inframarginal costs developed using unadjusted volume variable costs) for each product with adjusted volume variable costs for each product. Such a shortcut may be the best available option, although the result is clearly an imprecise estimate of inframarginal costs.

⁴ While those without access to the Nonpublic CRA in USPS-FY16-NP11 cannot directly see the two actual rows of NSA and non-NSA costs displayed for competitive products, that format can be verified from the public/nonpublic crosswalk table presented in Attachment Two to this document, the Application for Nonpublic Treatment. Moreover, a similar structure can be seen in the Public CRA in USPS-FY16-1, in which information for the NSA portion of Standard Mail is displayed in a row labelled "Standard Mail NSAs." The further breakout of the aggregate costs in the NSA rows to individual NSA products can be found for market dominant NSAs in USPS-FY16-30, and for competitive product NSAs in USPS-FY16-NP27.

cannot be generated using the current incremental cost model to allow reporting of incremental costs for each individual NSA. While the Postal Service is trying to explore alternative ways to derive incremental cost estimates for individual NSA products, the limited time available since the issuance of Order No. 3506 has not been sufficient to allow that difficulty to be overcome.⁵ Consequently, as yet, there is no comprehensive and complete set of product-level incremental costs.

Therefore, to the extent that some may have hoped that the CRA Report for FY2016 could reflect a full transition to the costing scheme ultimately contemplated by Order No. 3506, that aspiration has not been fulfilled. Because of the above-described constraints, the basic format of the CRA Report itself remains as it was in FY2015. The primary change in the CRA Report itself has been a cosmetic one to revise the title of the column previously labelled “Attributable” to the more descriptive “Volume Variable & Product Specific.” With this change, possible misunderstanding can hopefully be avoided that otherwise might arise (in light of Order No. 3506’s directives with respect to the new measure of attributable cost) if the column were still labelled as “Attributable.” Fundamentally, however, the substantive contents of the CRA Report are directly comparable to the content in previous years.

But, in accordance with the intentions expressed in Order No. 3506, a great deal of additional information not provided in previous ACRs is now submitted this year as well. Specifically, in the past, folder NP10 presented only the group incremental costs of the aggregation of competitive products as a whole. This year, USPS-FY16-NP10

⁵ At the moment, therefore, the incremental cost situation with respect to individual NSA products is comparable to the situation already acknowledged by the Commission with respect to international mail, in which reliance would have to remain on volume variable and product specific costs as the best available proxy.

again presents those group incremental costs, but also provides estimates (to the extent possible) of individual competitive products (or, as discussed above, “product types”). Similarly, a new folder, USPS-FY16-43, presents the incremental costs for market dominant products. In accordance with footnote 79 on page 60 of Order No. 3506, all of these estimates are generated by modifying the same spreadsheet previously used in folder NP10 to estimate the group incremental costs of competitive products as a whole. Moreover, to compensate for the inability to present a revised format for the CRA Report itself, the revenues associated with the product or “product type” reflected in each row of the incremental cost summary tables also appear in the same row of those tables. This allows direct computation and presentation of an incremental cost coverage (after final adjustments) for each row, consistent with the cost coverage discussion on page 61 of Order No. 3506.⁶

The availability of this expanded set of incremental cost information potentially affects the ACR in several ways. For example, in the application of the cross-subsidy test for competitive products required under subsection 3633(a)(1) of title 39, there is no change. The analysis still compares the sum of competitive products’ revenues with the group incremental costs of competitive products as a whole (which are calculated in USPS-FY16-NP10 as they have been in the past). But to ensure that each individual competitive product (or “product type”) maintains a cost coverage of no less than 100 percent, as required by subsection 3633(a)(2), the newly-developed set of product-level incremental cost estimates in USPS-FY16-NP10 is now available. Comparing the Nonpublic CRA in USPS-FY16-NP11 with the incremental cost reported in USPS-FY16-

⁶ Moreover, just as the Public CRA shows costs for six groups of Competitive Products, available incremental cost information for four of those groups are likewise shown in USPS-FY16-43.

NP10, each of the competitive products and “product types” with a cost coverage of 100 percent or greater in the Nonpublic CRA likewise has an incremental cost coverage of 100 percent or greater in USPS-FY16-NP10. Therefore, to the extent that pertinent information is available, using either the Order No. 3506 measure of attributable costs or the previous measure still reflected in this year’s CRA Reports does not, as an empirical matter, affect evaluation for FY 2016 of the cost coverage standard codified in subsection 3633(a)(2).

Subsection 3633(a)(3) requires that competitive products collectively recover an appropriate share of institutional costs. To ensure compliance with this provision, the target institutional cost share is compared with the difference between the sum of the competitive products’ revenues and the aggregate sum of the competitive products’ costs. Order No. 3506 did not specifically address how this exercise was to be conducted. For FY2016, this provision is being evaluated using the same procedures and the same inputs as in previous years. The competitive products’ costs used in this exercise remain the sum of the volume variable and product specific costs for each product. Additionally, consistent with how this exercise has been conducted in the past, institutional costs are defined as the difference between total accrued costs and the sum of the costs of each market dominant and competitive product shown in the CRA Report. Going forward, and specifically in response to the new rules adopted in Order No. 3641 (December 1, 2016) that will take effect next year, the Postal Service will be evaluating how to apply this test in future years.

In chronological order, the table below lists (including Notice date and Final Order date) the Postal Service's proposals to change analytic principles that have been filed, or are still pending, since the 2015 ACR was filed.

PROP NO.	TOPIC	FILING DATE	DOCKET	NOT ORD NO	NOT DATE	RULING FIN ORD NO	FIN ORD DATE
Nine	Refine Split of City Carrier Costs into Office and Street Components	10/31/14	RM2015-2	2238	11/4/14	Denied/ 3526	9/22/16
One	Proposed Change in Methodology for Outbound RPW Reporting (SIRVO)	4/5/2016	RM2016-7	3225	4/8/16	Approved/ 3377	6/17/16
Two	A Proposed Change for Distribution of International Delivery Costs	8/22/16	RM2016-10	3484	8/25/16	Approved/ 3621	11/17/16
Three	Proposed Change to In-Office Cost System Sampling of City Carriers	8/22/16	RM2016-11	3489	8/26/16	Withdraw n/ 3559	10/7/16
Four	Incorporate the Variability of Capacity with Respect to Volume into the Calculation of Attributable Purchased Highway Transportation Costs	8/22/16	RM2016-12	3482	8/24/16		

II. MARKET DOMINANT PRODUCTS

Below, the Postal Service discusses, for each market dominant mail class, FY 2016 costs, revenues, and volumes by product, as well as intra-product workshare discounts and passthroughs. Comprehensive cost, revenue, and volume data are contained in the CRA, at USPS-FY16-1, and in the ICRA, at USPS-FY16-NP2. Full data regarding workshare discounts and passthroughs are contained in USPS-FY16-3.

With respect to passthroughs generally, the Postal Service reiterates its longstanding position that section 3622(e) applies over the long term, as a principle guiding pricing over a series of price adjustments. This approach is consistent with subsections (B) and (D) of section 3622(e)(2) – the efficient operation of the Postal Service and the need to mitigate rate shock necessitate a measured approach to adjusting passthroughs. It would be inefficient and unduly disruptive to the Postal Service and to its customers to immediately adjust prices to correct passthroughs that exceed 100 percent.

Ultimately, the best approach is to address these passthroughs later, when there is more cap space available, taking into consideration the complex interrelationship between prices within a class, and considering current business needs. Thus, the Postal Service will address those passthroughs that exceed 100 percent in its next general price adjustment, which will then be reviewed by the Commission. This approach is no less appropriate now than in prior years. Overall, when compared to prior years, the workshare discount picture for FY 2016 falls within the limits of what can reasonably be addressed by a measured approach, viewed both in terms of the

proportion of total passthroughs that are over 100 percent, and in terms of the size of those passthroughs.

A First-Class Mail

1. Cost, Revenues, and Volumes

Costs, revenues, and volumes for First-Class Mail products appear below.

Table 1: First-Class Mail Volume, Revenue, and Cost by Product

Product	Volume (million)	Revenue (\$million)	Vol Var & Prod Spec	Contribution	Revenue/Piece	Cost/ Piece	Unit Contribution	Cost Cover-age
Single-Piece Letters/Cards	19,706	\$9,741	\$5,554	\$4,187	\$0.494	\$0.282	\$0.212	175.39%
Presorted Letters/Cards	39,943	\$15,417	\$4,577	\$10,840	\$0.386	\$0.115	\$0.271	336.83%
Flats	1,570	\$2,202	\$1,531	\$671	\$1.402	\$0.975	\$0.427	143.85%
Parcels	254	\$711	\$588	\$123	\$2.800	\$2.315	\$0.485	120.93%
First-Class Mail Fees		\$137						
Total First-Class Domestic Mail (incl. fees)	61,473	\$28,207	\$12,249	\$15,957	\$0.459	\$0.199	\$0.260	230.3%
Outbound Single-Piece First-Class Mail Int'l	172	\$262	\$155	\$107	\$1.522	\$0.900	\$0.622	169.06%
Inbound Single-Piece First-Class Mail Int'l	392	\$266	\$408	-\$142	\$0.680	\$1.042	-\$0.362	65.27%
Total First-Class Mail	62,037	\$28,735	\$12,812	\$15,923	\$0.463	\$0.207	\$0.257	224.28%

As shown above, with the exception of Inbound Letter Post from Transition Countries, all First-Class Mail products covered their attributable costs in FY 2016, with most of them contributing significantly to institutional costs. This comports with the historical role of First-Class Mail as providing the highest contribution to institutional costs of all mail classes. The trend of declining First-Class Mail volume continues, albeit at a slowing rate: 6.6 percent in FY 2010, 6.4 percent in FY 2011, 5.6 percent in

FY 2012, 4.2 percent (or 2.9 billion pieces) in FY 2013, 3.3 percent (2.2 billion pieces) in FY 2014, 2.1 percent (1.4 billion pieces) in FY 2015 and 1.9 percent (1.2 billion pieces) in FY 2016.

The cost coverage for First-Class Mail Parcels is a healthy 120.93 percent. Revenue per-piece increased from \$2.722 in FY 2015 to \$2.800 in FY 2016 while the cost per-piece declined from \$2.430 to \$2.315, once again producing a relatively significant increase in cost coverage from 112.0 percent to 120.93 percent.

The failure of Inbound Letter Post from Transition Countries to cover its attributable costs stems from the product's unique pricing regime. The Postal Service does not independently determine the prices for delivering foreign origin mail. Rather, these prices are set according to a Universal Postal Union (UPU) terminal dues formula established in the Universal Postal Convention. The formula for Inbound Letter Post from Transition Countries is based on a flat rate per kilogram, instead of on actual costs. Inbound Letter Post from Target Countries did cover its attributable costs in FY 2016. This is because the terminal dues formula for Inbound Letter Post from Target Countries is based on a percentage of the one-ounce retail Single-Piece First-Class Mail Letter price and the six-ounce First-Class Mail Flat price, which better reflect actual costs. The Postal Service has been collaborating with other federal agencies, including the Department of State, which has lead responsibility for representation of the United States in the UPU, to improve cost coverage on inbound international Letter Post mail. Based on outcomes at the UPU Istanbul Congress, the Postal Service expects significant increases in Inbound Letter Post terminal dues revenues based on the new Convention cycle effective in January 2018. In the meantime, in calendar year 2017,

the Postal Service will benefit from scheduled increases in terminal dues for Inbound Letter Post mail under the graduated increases established in Articles 30 and 31 of the existing Universal Postal Convention.

2. Workshare Discounts and Passthroughs

i. Presorted Letters and Cards

Out of the nine First-Class Mail Presorted Letters and Cards workshare discounts, the passthroughs for four exceed 100 percent of the estimated cost avoidance: Automation AADC Letters (111.1 percent), Automation Mixed AADC Cards (183.3 percent), Automation AADC Cards (150.0 percent), and Automation 5-Digit Cards (118.2 percent).

Because of the FY 2016 cost avoidance update, the Mixed AADC Automation Letters passthrough complies with 3622(e)(2) with a passthrough of 79.3 percent, compared to 139.4 percent in FY 2015 and 112.1 percent in Docket No. R2017-1.⁷ In FY 2016, the cost avoidance increased by 75 percent to 5.8 cents, up from 3.3 cents in FY 2015; between FY 2014 and FY 2015, the cost avoidance decreased by 28 percent, from 4.6 cents to 3.3 cents. The Postal Service employs the Commission-approved methodology to update the cost avoidance annually, but the resulting estimated cost avoidance fluctuates from year to year. Changing prices to match volatile cost avoidances is not efficient for pricing or running a business.

⁷ See Unites States Postal Service Notice of Market Dominant Price Adjustment, Docket No. R2017-1 (Oct. 12, 2016), at 43 n.39 (providing a complete history of the Mixed AADC Automation Letters cost avoidances and passthroughs since the FY 2007 ACD).

Automation AADC Letters

The passthrough for AADC Automation Letters is 111.1 percent (discount of 2 cents compared to the cost avoidance of 1.8 cents). This particular passthrough was 145 percent in FY 2014 (discount of 2.9 cents versus the cost avoidance of 2 cents). In Docket No. R2015-4, the Postal Service reduced the discount of 2.6 cents (based on CPI prices) to 2 cents to match the cost avoidance of 2 cents, resulting in a passthrough of 100 percent. As noted in the FY 2015 ACR, this passthrough exceeded 100 percent in FY 2015 only because Exigent prices were in effect.⁸ On April 10, 2016, the date on which the Postal Service rolled back Exigent prices, the passthrough fell back into compliance. Recently, in Docket No. R2017-1, the Postal Service maintained the discount at 2 cents to align the discount with the FY 2015 cost avoidance. However, because the cost avoidance shrunk by 10 percent in FY 2016 from 2 cents to 1.8 cents, the passthrough increased to 111.1 percent.

No statutory exception exists to address the fact that cost avoidances for each fiscal year are estimated after the end of the fiscal year, and too late to be factored into an annual price change filed before the new cost avoidances are available. Therefore, the Postal Service is not justifying this passthrough pursuant to 3622(e)(2), but will either fix the discount in its next annual market-dominant price change or cite to a statutory exception at that time, taking into consideration other business needs at the time of the price change.

⁸ FY 2015 ACR at 10.

Automation Mixed AADC Cards

The passthrough for Mixed AADC Automation Cards is 183.3 percent (discount of 1.1 cents and cost avoidance of 0.6 cent). In FY 2015, the passthrough was 110 percent due to the Exigent prices in effect. Previously, this passthrough was exactly 100 percent in Docket No. R2015-4. In that case, the Postal Service actually reduced the discount from 1.5 cents to 1.1 cents, and relied on the FY 2014 avoided cost of 1.1 cents to calculate the passthrough. Once again in Docket No. R2017-1, the Postal Service reduced the discount to 1 cent to match the FY 2015 cost avoidance of 1 cent. However, because the cost avoidance shrunk to 0.6 cent in FY 2016, the passthrough increased to 183.3 percent. The Postal Service notes that when the Docket No. R2017-1 prices take effect on January 22, 2017, the passthrough will improve slightly to 166.7 percent.

No statutory exception exists to address the fact that cost avoidances for each fiscal year are estimated after the end of the fiscal year, and too late to be factored into an annual price change filed before the new cost avoidances are available. Therefore, the Postal Service is not justifying this passthrough pursuant to 3622(e)(2), but will either fix the discount in its next annual market-dominant price change or cite to a statutory exception at that time, taking into consideration other business needs at the time of the price change.

Automation AADC Cards

The passthrough for AADC Automation Cards is 150.0 percent (discount of 0.9 cents and cost avoidance of 0.6 cent). In FY 2015, the passthrough exceeded 100 percent due to the Exigent prices then in effect. In Docket No. R2015-4, this

passthrough was exactly 100 percent. In that case, the Postal Service actually reduced the discount from 1.3 cents to 0.9 cents, and relied on the FY 2014 avoided cost of 0.9 cents to calculate the passthrough. Once again in Docket No. R2017-1, the Postal Service reduced the discount to 0.8 cent to match the FY 2015 cost avoidance of 0.8 cent. However, because the cost avoidance shrunk to 0.6 cent in FY 2016, the passthrough increased to 150.0 percent. The Postal Service notes that when the Docket No. R2017-1 prices take effect on January 22, 2017, the passthrough will improve slightly to 133.3 percent.

No statutory exception exists to address the fact that cost avoidances for each fiscal year are estimated after the end of the fiscal year, and too late to be factored into an annual price change filed before the new cost avoidances are available. Therefore, the Postal Service is not justifying this passthrough pursuant to 3622(e)(2), but will either fix the discount in its next annual market-dominant price change or cite to a statutory exception at that time, taking into consideration other business needs at the time of the price change.

Automation 5-Digit Cards

The passthrough for AADC Automation Cards is 118.2 percent (discount of 1.3 cents and cost avoidance of 1.1 cent). In FY 2015, the passthrough exceeded 100 percent due to the Exigent prices in effect. This passthrough was exactly 100 percent in Docket No. R2015-4. Using the avoided cost of 1.3 cents in FY 2014, the Postal Service increased the discount from 1.2 cents to 1.3 cents. In Docket No. R2017-1, the Postal Service maintained the discount at 1.3 cent to match the FY 2015 cost avoidance of 1.3

cent. In FY 2016, the cost avoidance shrunk to 1.1 cent making this passthrough 118.2 percent.

No statutory exception exists to address the fact that cost avoidances for each fiscal year are estimated after the end of the fiscal year, and too late to be factored into an annual price change filed before the new cost avoidances are available. Therefore, the Postal Service is not justifying this passthrough pursuant to 3622(e)(2), but will either fix the discount in its next annual market-dominant price change or cite to a statutory exception at that time, taking into consideration other business needs at the time of the price change.

ii. Flats

In Flats, all three passthroughs exceed 100 percent: ADC Automation Flats; 3-Digit Automation Flats; and 5-Digit Automation Flats.

ADC Automation Flats

The passthrough for ADC Automation Flats is 109.6 percent (discount of 8 cents compared to the cost avoidance of 7.3 cents). In FY 2015, this passthrough was 81.6 percent (discount of 8 cents compared to the cost avoidance of 9.8 cents). In Docket No. R2015-4, the passthrough was 100 percent (discount of 8 cents compared to the cost avoidance of 8 cents). The cost avoidance increased from 8 cents to 9.8 cents between FY 2014 and FY 2015, and the Postal Service maintained the discount at 8 cents in Docket No. R2017-1, which kept the passthrough below 100 percent. In FY 2016, the cost avoidance declined from 9.8 cents to 7.3 cents increasing the passthrough from 81.6 percent to 109.6 percent. Had the Postal Service increased the

discount to match the FY 2015 avoided cost in Docket No. R2017-1, the FY 2016 passthrough would be even further above 100 percent.

No statutory exception exists to address the fact that cost avoidances for each fiscal year are estimated after the end of the fiscal year, and too late to be factored into an annual price change filed before the new cost avoidances are available. Therefore, the Postal Service is not justifying this passthrough pursuant to 3622(e)(2), but will either fix the discount in its next annual market-dominant price change or cite to a statutory exception at that time, taking into consideration other business needs at the time of the price change.

3-Digit Automation Flats

The passthrough for 3-Digit Automation Flats is 102.6 percent (discount of 4 cents compared to the cost avoidance of 3.9 cents). In FY 2015, this particular passthrough was 80 percent (discount of 4 cents compared to cost avoidance of 5 cents). In Docket No. R2015-4, the passthrough was 100 percent (discount of 4 cents compared to the cost avoidance of 4 cents). The cost avoidance increased from 4 cents to 5 cents between FY 2014 and FY 2015 but the discount was maintained at 4 cents in Docket No. R2017-1, which kept the passthrough below 100 percent. In FY 2016 the cost avoidance declined from 5 cents to 3.9 cents increasing the passthrough from 80 percent to 102.6 percent. Had the Postal Service increased the discount to match the FY 2015 avoided cost in Docket No. R2017-1, the FY 2016 passthrough would be even further above 100 percent.

No statutory exception exists to address the fact that cost avoidances for each fiscal year are estimated after the end of the fiscal year, and too late to be factored into

an annual price change filed before the new cost avoidances are available. Therefore, the Postal Service is not justifying this passthrough pursuant to 3622(e)(2), but will either fix the discount in its next annual market-dominant price change or cite to a statutory exception at that time, taking into consideration other business needs at the time of the price change.

5-Digit Automation Flats

The passthrough for 5-Digit Automation Flats is 161.3 percent (discount of 19.2 cents compared to the cost avoidance of 11.9 cents). This particular passthrough was 120.8 percent in FY 2015 (discount of 19.2 cents versus the cost avoidance of 15.9 cents). In FY 2014, the passthrough was 120.4 percent (discount of 18.3 cents versus the cost avoidance of 15.2 cents), and in FY 2013, the passthrough was 133.3 percent (discount of 18.8 cents compared to a cost avoidance of 14.1 cents). The cost avoidance has not dropped below the FY 2013 level of 14.1 cents since FY 2007, when the cost avoidance also equaled approximately 11.9 cents the same as the FY 2016 cost avoidance.

In Docket No. R2015-4, this passthrough was 126.3 percent, which the Postal Service justified pursuant to 3622(e)(2)(B), rate shock.⁹ In Docket No. R2017-1, the Postal Service reduced the passthrough to 115.7 percent (using FY 2015 costs), and again justified it pursuant to the rate shock exception.¹⁰ The Commission accepted the Postal Service's justification in both cases. Given the volatility of the cost avoidance

⁹ United States Postal Service Notice of Market-Dominant Price Adjustment, Docket No. R2015-4 (Jan. 15, 2015), at 44–45; Responses of the United States Postal Service to Chairman's Information Request, No. 2, Docket No. R2015-4 (Feb. 2, 2015), at Question 1.

¹⁰ United States Postal Service Notice of Market Dominant Price Adjustment, Docket No. R2017-1 (Oct. 12, 2016), at 44-45.

estimate, which dropped sharply between FY 2015 and FY 2016, the Postal Service justifies the Automation 5-Digit Flats passthrough under 3622(e)(2)(B), the rate shock exception. Reducing the passthrough to 100 percent would require up to a 16.7 percent price increase (or a 10.3 percent price decrease) which is not justified under these circumstances. The Postal Service notes that when the Docket No. R2017-1 prices take effect on January 22, 2017, the passthrough will decrease slightly to 154.6 percent. The Postal Service plans to improve the passthrough in its next annual market-dominant price change, consistent with its rate shock concerns, and taking into consideration other business needs at the time of the price change.

3. First-Class Mail Promotions

The five promotions discussed below were in effect for First-Class Mail in FY 2016. The Color Transpromo Promotion and the Advanced and Emerging Technology Promotion were offered in calendar year 2015. The Emerging and Advanced Technology/Video in Print Promotion; the Earned Value Reply Mail Promotion; and the Personalized Color Transpromo Promotion were offered in calendar year 2016.

Color Transpromo Promotion

The Color Transpromo Promotion (June 1 to November 30, 2015) provided participating mailers an upfront two-percent postage discount on bills and statements mailed as First-Class Mail presort or automation letters. To qualify, mailpieces are required to feature marketing messages in dynamic/variable color print. Between October 1 and November 30, 2015, the Postal Service issued approximately \$3.2 million in discounts for roughly 398 million First-Class Mail pieces.

Advanced and Emerging Technology Promotion

The Advanced and Emerging Technology Promotion (June 1 to November 30, 2015) provided participating mailers an upfront two-percent postage discount on regular and nonprofit Standard Mail letters and flats, and First-Class Mail presort and automation letters, cards, and flats. To qualify, mailpieces were required to feature advanced technology (such as print technology, Near Field Communication, or augmented reality) leading to a mobile experience. Between October 1 and November 30, 2015, the Postal Service issued \$573,597 in discounts for approximately 71 million First-Class Mail pieces.

Emerging and Advanced Technology/Video in Print Promotion

The Emerging and Advanced Technology/Video in Print Promotion (March 1 to August 31, 2016) provided participating mailers an upfront two-percent postage discount on regular and nonprofit Standard Mail letters and flats, and First-Class Mail presort or automation letters, cards, and flats. To qualify, mailpieces were required to feature advanced technology such as Near Field Communication, enhanced augmented reality, or Video in Print. The 2016 promotion also offered an A/B testing option, under which a limited number of pieces not otherwise meeting the promotion's eligibility requirements were eligible to receive the two-percent discount, provided mailers used A/B testing protocols to compare customer response rates to mailpieces featuring qualifying technology (design A), with customer response rates to mailpieces featuring nonqualifying design treatments (design B), and provided the results of that testing to the Postal Service. Over the course of the program, the Postal Service issued approximately \$3.7 million in discounts for roughly 485 million First-Class Mail pieces.

Earned Value Reply Mail Promotion

The Earned Value Reply Mail Promotion (April 1 to June 30, 2016) provided participating mailers a two-cent postage credit for each First-Class Mail Business Reply Mail (BRM) and Courtesy Reply Mail (CRM) piece returned to the mailer during the promotion period. Mailers that participated in the 2015 Earned Value Reply Mail Promotion and either met or increased their volume of qualifying BRM/CRM pieces in 2016 received an additional one cent per piece, for a total per-piece postage credit of three cents. At the end of the promotion period, the total credit amount earned was applied to the mailer's permit account for application to future mailings for First-Class Mail presort and automation letters, cards, and flats, and Standard Mail letters and flats. Over the course of the program, the Postal Service issued approximately \$10.5 million in credits for roughly 453.7 million BRM and CRM pieces. To date, approximately \$7.3 million worth of credits have been used on First-Class Mail.

Personalized Color Transpromo Promotion

The Personalized Color Transpromo Promotion (July 1 to December 31, 2016) provides participating mailers an upfront two-percent postage discount on bills and statements mailed as First-Class Mail presort or automation letters. To qualify, mailpieces are required to feature personalized transpromotional marketing messages in dynamic/variable color print. As of September 30, 2016, the Postal Service issued approximately \$3 million in discounts for roughly 404.9 million First-Class Mail pieces.

B. Standard Mail

1. Cost, Revenues, and Volumes

Costs, revenues, and volumes for Standard Mail products appear below.

Table 2: Standard Mail Volume, Revenue, and Cost by Product

Product	Volume (million)	Revenue (\$million)	Volume Variable & Product Specific Costs	Contri- bution	Revenue/ Piece	Cost/ Piece	Unit Contri- bution	Cost Cover- age
HD/Sat Letters	6,992	\$1,075	\$492	\$583	\$0.154	\$0.070	\$0.083	218.39%
HD/Sat Flats & Parcels	11,047	\$2,004	\$1,190	\$814	\$0.181	\$0.108	\$0.074	168.41%
Carrier Route Letters	6,642	\$1,793	\$1,304	\$489	\$0.270	\$0.196	\$0.074	137.53%
Letters	48,859	\$10,134	\$5,023	\$5,111	\$0.207	\$0.103	\$0.105	201.75%
Flats	6,307	\$2,368	\$2,970	(\$602)	\$0.375	\$0.471	(\$0.095)	79.73%
Parcels	45	\$53	\$83	(\$30)	\$1.187	\$1.860	(\$0.673)	63.80%
Every Door Direct Mail Retail	810	\$146	\$54	\$92	\$0.180	\$0.067	\$0.113	269.45%
Standard Mail NSAs	228	\$54	\$49	\$5	\$0.236	\$0.216	\$0.020	109.37%
Standard Mail Fees		\$48						
Total Standard Mail (incl. fees)	80,930	\$17,675	\$11,165	\$6,510	\$0.218	\$0.138	\$0.080	158.30%

As shown above, all Standard Mail products, other than Standard Mail Parcels and Standard Mail Flats, covered their costs in FY 2016. As a class, Standard Mail covered its volume variable and product specific costs and contributed significantly to institutional costs.

Under section 3626(a)(6), when the Postal Service adjusts Standard Mail prices, the estimated average revenue per piece for Standard Mail sent by nonprofit mailers must equal, as nearly as practicable, 60 percent of the estimated average revenue per piece for Standard Mail sent by commercial customers. For FY 2015, the ratio was 59.19 percent.

i. Standard Mail Parcels

Standard Mail Parcels covered 63.8 percent of its volume variable and product specific costs in FY 2016, down from 72.8 percent in FY 2015. This was partly due to a slight increase in labor costs combined with a substantial decrease in parcel volume. The combination of these two trends caused unit costs to increase significantly in a

Fiscal Year where the only price adjustment was negative (the rollback of Exigent prices on April 10, 2016.) Another factor in the decreasing cost coverage is that irregular parcels (which have a lower cost coverage than marketing or machinable parcels) accounted for a larger percentage of total Standard Mail Parcel volume in FY 2016. Despite this setback, the Postal Service is committed to improving this product's cost coverage by proposing above-average price increases in future general market-dominant price adjustments. As an example of this, in Docket No. R2017-1, the price increase for Standard Parcels was 1.583 percent, 76 percent higher than the average price increase in Standard Mail.

ii. Standard Mail Flats

Standard Mail Flats covered 79.7 percent of its volume variable and product specific costs in FY 2016, down 0.4 percentage points from FY 2015. This was due to a significant decline in revenue per piece. Revenue per piece declined as a result of: 1) the rollback of exigent prices on April 10, 2016; and 2) the migration of Carrier Route FSS pieces to Standard Mail Flats being reflected in all four quarters of FY 2016 (as opposed to only one quarter of FY 2015).¹¹ However, the decline in revenue per piece was almost entirely offset by a corresponding 6 percent decrease in cost per piece, relative to what was reported in FY 2015. The decline in unit cost was most likely caused in part by the migration of Carrier Route volume into Standard Mail Flats. Absent this migration, the exigent rollback likely would have driven the cost coverage even lower.

¹¹ The migration of Carrier Route FSS pieces to Standard Mail Flats began after the implementation of the prices from Docket No. R2015-4 on May 31, 2015. The migration of Carrier Route FSS pieces to Standard Mail Flats reduced revenue per piece, because the Carrier Route pieces migrated into the lowest Standard Mail Flats price category.

As the Postal Service has stated in the past, it agrees with the Commission that having products cover their costs is an appropriate long-term goal.¹² As part of its ACR for FY 2012, the Commission directed the Postal Service to “respond to the specific remedy adopted by the 2010 ACD by presenting a schedule of future price adjustments for Standard Mail Flats.”¹³ In the ACR for FY 2013, the Postal Service complied with the Commission’s directive by presenting a three-year schedule of above-average CPI price increases for Standard Mail Flats.¹⁴ The Commission approved the schedule of above-average price increases in its ACD for FY 2013.¹⁵ In Docket No. R2017-1, the Postal Service presented, and the Commission approved, an updated three-year schedule of above average price increases for Standard Mail Flats price.¹⁶

In compliance with the Commission’s order in the ACD for FY 2010, and the recently approved schedule of above average price increases, the Postal Service plans to increase Standard Mail Flats prices by at least 1.05 times CPI in the next general market-dominant price change. It should be noted, however, that the Postal Service has surpassed its Standard Mail Flats pricing commitments by wide margins in recent price adjustments. For example, the Postal Service increased Standard Mail Flats prices in Docket No. R2017-1 by 2.522 percent, which was 290 percent above the available CPI price adjustment authority.

¹² See, e.g., United States Postal Service FY 2013 Annual Compliance Report, PRC Docket No. ACR2013 (December 27, 2013), at 19 (*hereinafter* “ACR for FY2013”).

¹³ Order No. 1472, Notice and Order Confirming Termination of Stay, PRC Docket No. ACR2010-R (Sept. 21, 2012), at 3.

¹⁴ ACR for FY2013, at 20.

¹⁵ Annual Compliance Determination Report, Fiscal Year 2013, PRC Docket No. ACR2013 (Mar. 27, 2013), at 52-54.

¹⁶ Docket No. R2017-1, Response of United States Postal Service to Questions 2-8 of Chairman’s Information Request No. 4, Question 4 (October 26, 2016); Docket No. R2017-1, Order No. 3610 - Order on Price Adjustments for First-Class Mail, Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, at 31-32 (November 15, 2016).

In addition, in the FY 2010 ACD, the Commission ordered the Postal Service to provide the following information about Standard Mail Flats in each subsequent Annual Compliance Report:

- a) all operational changes designed to reduce flats costs in the previous fiscal year and an estimation of the financial effects of such changes;
- b) all costing methodology improvements made in the previous fiscal year and the estimated financial effects of such changes; and
- c) a statement summarizing the historical and current fiscal year subsidy of the flats product; and the estimated timeline for phasing out this subsidy.¹⁷

The Postal Service provides the information below in response to the Commission's directives. The section titled "Operational Changes" responds to directive (a), and the section titled "Costing Methodology Changes and Subsidy of the Flats Product" responds to directives (b) and (c).

Operational Changes

Below, the Postal Service describes the new and ongoing steps it took during FY 2016 to make its processing of Standard Mail Flats and Periodicals mail more efficient. Collectively, these efforts are expected to improve efficiencies and productivities, and contribute to reductions in overall Standard Mail Flats and Periodicals costs.

Where possible, the Postal Service has developed key metrics to monitor and gauge the operational impact of changes, specifically related to flat mail processing. The metrics described in the following sections are used on a daily basis to identify operational or maintenance issues that may be impacting the overall efficiency of the operations monitored. As situations change, these metrics may be modified or

¹⁷ Annual Compliance Determination Report: Fiscal Year 2010, PRC Docket No. ACR2010 (Mar. 29, 2011), at 107.

discontinued and other metrics may be added. In many cases, the operational metrics employed are aggregate in nature, crossing different mail classes and entry make-up.

However, the Postal Service is unable to provide an estimate of the financial impacts of these operational initiatives at this time. As the Postal Service explained in its responses to the Commission's directive in Chapter 6 of its FY 2015 ACD,¹⁸ the information generated by the Postal Service's existing data systems does not support reliable estimates of the impact of operational initiatives on flats costs. The Postal Service believes that its responses to the Chapter 6 directive embody the initial steps toward developing useful metrics in the context of postal operations, at a reasonable level of detail given the Postal Service's limited resources.

- **FSS Scorecard**

The Postal Service continues to measure critical aspects of FSS performance at each processing location. The resulting scorecard is utilized to develop a list of specific sites with the greatest opportunity for improvement. The below table reflects the Postal Service's performance on the key metrics utilized by the scorecard.

Performance Metric	FY 15	FY 16
Throughput per hour (pph)	8,840	8,326
Delivery Point Sequence (DPS)	59.99%	56.73%
Mail Pieces At-Risk	5.34%	5.67%

Sources:

Throughput per hour:	WebEOR
DPS %:	EDW
At-Risk:	MIRS

¹⁸ Response of the United States Postal Service to Commission Information request No. 1, Docket No. ACR2015 (November 28, 2016); Third Response of the United States Postal Service to Commission Requests for Additional Information in the FY 2015 Annual Compliance Determination, Docket No. ACR2015 (July 26, 2016).

The DPS percentage metric represents the percentage of all flats designating in FSS zones that was sorted to DPS using FSS for city carrier delivery. Flats volume outside of the FSS DPS percentage is either processed on the automated flat sorting machine (AFSM) or in manual operations

The Mail Pieces At-Risk percentage identifies the percentage of mail that does not follow the prescribed path of sortation through a machine-based operation (e.g., on the FSS). These pieces, while not representative of service failures, require some additional handling in order to ensure they meet service expectations.¹⁹ At-Risk metrics enable the Postal Service to identify operational processes and machine elements that need to be reviewed for possible improvement. The metrics are broken down into three groups – Maintenance, Operator, and Shared (both Maintenance and Operator) – based on the ability of that group to affect the metric being tracked. Data supporting these metrics are gathered from machine End-of-Run (EOR) statistics. The Postal Service uses raw event indicators from the machine, such as the number of jams, and extrapolates the potential number of pieces that have fallen outside normal processing. Proper maintenance and adherence to operational guidelines minimizes the pieces at risk, hence decreasing the indicator.

- **Bundle Operation**

The Automated Parcel and Bundle Sorter (APBS) sorts packages and bundles of flats to bins for either delivery or subsequent processing. At some locations, processing

¹⁹ The At-Risk metric calculation includes measurements that account for mail that is misfaced, when a mail piece's destination is not defined in the equipment sort plan, machine emergency stops, mail pieces with no address read, jams (feeder, tray, infeed, and ITC), machine stops, rejection of mail piece from automated processing due to equipment not reading address in a sufficient amount of time, mail pieces returned by a keyer, mechanical rejects, culling rejects, mail not presented to the correct feeder in the correct order (sequencing rejects), out of sequence trays, double feeds, and recycling rejects.

packages to destination requires two runs on the machine – a primary sortation and a secondary sortation. By making additional bins available for the primary sortation, the need for a secondary sortation is reduced or eliminated. For example, assume that a particular sortation requires 200 separations, but that the machine only has 150 bins. As a result, 50 separations require rehandling. The introduction of additional bins eliminates or reduces this extra handling.

In FY 2014, the Postal Service began expanding the capacity of APBS machines by adding 1,264 bins for sortation. In FY 2015, the Postal Service added 3,520 additional bins nationwide. In FY 2016, the Postal Service completed the APBS bin expansion with the addition of 2,144 bins.

The APBS bin expansion program (see chart below) was justified based on the resulting reduction of manual handling for packages. However, these expansions will also improve finalization of bundles at many locations, as elimination of the second sortation makes the machine available for bundle processing.

	FY 14	FY 15	FY 16
# APBS Bins Installed	1,264	3,520	2,144

- **Service Performance Diagnostics Tool**

The Postal Service continues to utilize the Service Performance Diagnostics tool (SPD) to track and improve the flow of Standard Mail and Periodicals being processed through the network. The Work in Process (WIP) cycle time measures the time between a mail piece's arrival at the plant and bundle-to-piece distribution.

In FY 2016, there was a slight increase in WIP cycle time for both Standard Mail and Periodicals. The Postal Service continues to monitor WIP cycle time to identify locations and operations where the time between arrival and bundle-to-piece distribution can be improved. The Postal Service is consistently working to optimize its operations and reduce the cycle time between acceptance and processing.

Median 5 Day Mail Processing WIP Standard Mail Flats

Time Period from SPD	Weighted Median (hours)
(FY 15) Week ending 10/01/14 - 09/30/15	52
(FY 16) Week ending 10/01/15 - 09/30/16	54

Median 5 Day Mail Processing WIP Periodicals Flats

Time Period from SPD	Weighted Median (hours)
(FY 15) Week ending 10/01/14 - 09/30/15	23
(FY 16) Week ending 10/01/15 - 09/30/16	24

- **Lean Mail Processing**

In FY 2016, the Postal Service continued the national deployment of Lean Mail Processing (LMP) in mail processing facilities. The LMP program is a standardized, statistical program for improving mail processing. LMP phases one and two focused on foundational efforts affecting all mail processing operations, including flats. Initiatives included improvement of overall facility organization, improvement of letter tray and flats tub management, expansion of Facility Access and Shipment Tracking appointments to meet customer needs, reduction of late trips departing the processing facilities,

reduction of letters processed on flats sorting equipment, and implementation of first-in-first-out staging, among others.

Phase three of LMP, deployed in early FY 2015, focused on Automated Package Processing System (APPS) and on APBS operations. The Postal Service issued revised guidelines for managing mail transportation equipment, designing staging areas, and making the best practical use of the machines, which improved operational performance by freeing up capacity on the machines for all products, including bundles.

Phase four of LMP, which was deployed late FY 2015 and continued in FY 2016, focuses on lean management systems and proactive problem solving when discrepancies are first detected. Personnel in each operational area in a plant, including flats and bundles operations, visually track their real-time performance to ensure they are on target and take appropriate actions to ensure operational goals are met. For example, management at a given plant may monitor and take note of productivity on the APBS throughout a tour to determine whether the operation is on pace to meet that tour's throughput goal, and make appropriate adjustments as needed to achieve that goal.

This chart represents the LMP implementation by phases and mail processing facilities. The number of mail processing facilities at which LMP has been deployed varies by phase, as some LMP projects do not apply to all operations.

LMP Phase	Fiscal Year Implementation	Mail Processing Facilities
Phase 1	FY 2013-2014	258
Phase 2	FY 2014	236
Phase 3	FY 2015	169
Phase 4	FY 2015-2016	272

- **Reduce Bundle Breakage**

Bundle breakage results in higher processing costs for the Postal Service, as well as potential damage to mail pieces. When bundles lose their presort integrity prior to being completely processed, the Postal Service must handle the individual pieces, which increased handling costs. Accordingly, reducing bundle breakage benefits both the Postal Service and the mailing industry.

The Postal Service is committed to working with the mailing industry, through the Mailers Technical Advisory Committee, to study the causes and impacts of bundle breakage. The Postal Service continues to share information with Mail Service Providers (MSPs) and their individual processing plants to identify areas of opportunity to reduce breakage. In FY 2016, the Postal Service began providing information about instances of bundle breakage to the MSPs and mail owners on a monthly basis.

In addition, the Postal Service is in the process of creating an internal dash board to give individual Postal Service processing plants quicker access to bundle breakage data, including, the total number of bundles processed on the APPS or APBS by a facility, and the percentage of that total that were identified as broken; the number of bundles processed by a facility as a percentage of total bundles processed nationwide; and the number of bundles identified as broken at a facility as a percentage of total bundles identified as broken nationwide. This information can also be broken down by machine type, by MSP, or by mail owner. The Postal Service and industry stakeholders use these data to gain insight into root causes of bundle breakage, to identify overarching impacts of bundle breakage on service, and to investigate top opportunity

facilities, locations, and machines in an effort to develop strategies to address bundle breakage.

- **Standard Mail Outgoing Mixed States**

In FY 2015, at the request of the mailing industry, the Postal Service conducted an analysis of outgoing mixed states processing. The analysis revealed 211 3-Digit ZIP codes for which mixed processing was being directed outside of the corresponding Network Distribution Center (NDC) service area. These mismatches had the potential to increase both processing and transportation costs. In FY 2016, the Postal Service realigned all 211 3-Digit ZIP codes to match the mixed states processing facilities with NDC network service areas.

Costing Methodology Changes and Subsidy of the Flats Product

In contrast with last year, during which three separate rulemaking dockets culminated in three costing methodology changes that affected Standard Mail Flats costs, there were no similar rulemaking dockets in FY 2016. Consequently, costing methodology changes do not explain any of the observed decline in the unit costs of Standard Mail Flats between FY 2015 and FY 2016.²⁰ Standard Mail Flats unit costs declined from 50.1 cents in FY 2015 to 47.1 cents in FY 2016.

However, while the directive in the FY2010 ACD only explicitly mentions discussion of changes in *costing methodology* (as well as operational changes), there were other related developments this year that require acknowledgment in order to

²⁰ The unit costs in FY 2015 were affected by a final adjustment associated with the FSS markings issue, developed in FY 2014 in USPS-FY14-45, and implemented for FY 2015 as described in USPS-FY15-31. That adjustment was in effect for only the first part of FY 2015, however, and expired in the later stages of that year. Its absence in FY 2016, therefore, does not constitute a costing methodology change, and in and of itself does not directly explain any portion of the change in unit costs.

foster a better understanding of the observed trend in reported costs for Standard Mail Flats. As described last year in the Preface to USPS-FY15-31, the preparation rules implemented in January 2014 allowed pieces in 5-digit scheme FSS bundles to claim Standard Mail Carrier Route rates, if they would have been eligible to do so in the absence of the FSS preparation rules. As also explained in the same Preface, marking issues related to this situation warranted costing adjustments that shifted to Carrier Route some costs that would otherwise have been reported as relating to Standard Flats. Those adjustments were in effect for the first three quarters of FY 2015. Because of classification changes made in Docket No. R2015-4, however, beginning May 31, 2015, all pieces in FSS bundles became part of the Standard Mail Flats product. See Order No. 2472, Docket No. R2015-4 (May 7, 2015). As a consequence of these circumstances, certain pieces that would have been classified as part of Carrier Route in the first three quarters of FY 2015 would, throughout FY 2016, have instead been classified as Standard Mail Flats. Therefore, when comparing the reported unit costs of Standard Mail Flats (and, for that matter, of Carrier Route) in FY 2016 to the reported unit costs in FY 2015, it is necessary to consider the effects of these classification changes.

When pieces move in or out a mail category, the effect on reported unit costs (which is to say, average costs per piece) is primarily a function of whether the subset of pieces that are shifting have higher than average costs (relative to the total set of pieces present before the shift), or lower than average costs. This is true with respect to both the category from which the pieces shift, as well as the category into which they shift. In terms of the instant discussion, we are evaluating more than one billion pieces that

shifted from Carrier Route (in FY 2015) in Standard Flats (in FY 2016). Those particular pieces would tend to be in the above-average portion of the cost distribution for Carrier Route (since they get distributed as pieces at the FSS operation and whatever operations handle the FSS rejects), but in the below-average portion for Standard Flats (since they have a 5D scheme presort). Moreover, there were a material number of pieces that made this shift, in excess of one billion pieces, as mentioned above. So, under these circumstances, one might expect that shifting these FSS CR flats from Carrier Route flats to Standard Flats could actually reduce unit Mail Processing costs for both products. Looking at the Mail Processing data for FY 2015 and FY 2016, this indeed seems to have been the case. Therefore, it seems quite plausible that some portion of the observed decline in the unit costs of Standard Flats between FY 2015 and FY 2016 was related to the June 2015 mail classification changes.²¹ More broadly, the series of events starting in January of 2014 relating to the preparation, marking, and classification of flat-shaped pieces of Standard Mail virtually ensured that unit costs trends for the affected products within Standard Mail would manifest some volatility.

With respect to Standard Mail Flats' financial shortfall, the below table summarizes the gap between revenues and costs, as reported in the Commission's ACDs from FY 2008 through FY 2015, and as reported in the FY 2016 CRA for this fiscal year:

²¹ Perhaps one reason why it is important to note the potential effects of these mail classification changes on reported unit costs is that, with the classification changes approved for Docket No. R2017-1, these results may be reversed going from FY 2016 to FY 2017 and beyond.

Year	Revenue (millions)	Cost (millions)	Shortfall (millions)
2008	\$3,673	\$3,891	\$218
2009	\$2,882	\$3,497	\$616
2010	\$2,592	\$3,169	\$577
2011	\$2,500	\$3,143	\$643
2012	\$2,234	\$2,762	\$528
2013	\$2,138	\$2,514	\$376
2014	\$2,041	\$2,452	\$411
2015	\$2,113	\$2,633	\$520
2016	\$2,368	\$2,970	\$602

As the Postal Service has consistently explained, it is very difficult to predict when the shortfall for Standard Mail Flats will be phased out. Certainly the termination of the exigent surcharge during FY 2016 did nothing to facilitate achievement of that objective. While the Postal Service will be implementing rate increases in January 2017 for Standard Mail Flats that will be well above the average for Standard Mail products overall (2.522 percent for Flats versus 0.900 percent for Standard Mail overall), and plans to increase the price of Standard Mail Flats by at least CPI times 1.05 during the next general market-dominant price change, it is now certain that the shortfall will not be eliminated prior to commencement of the comprehensive review of the present regulatory system required by section 3622(d)(3) of title 39.²² The prospects for eliminating the shortfall thereafter will depend not only on pricing and cost saving initiatives, but also on any changes made to applicable regulations by the Commission.

Nevertheless, it bears noting that the Standard Mail Flats shortfall in FY 2016 is still less than it was when the shortfall peaked in FY 2011. Moreover, due in part to the

²² The Commission initiated that review in Docket No. RM2017-3 on December 20, 2016.

classification changes noted above, the volume of Standard Mail Flats actually grew again in FY 2016 (by over 10 percent). When unit contribution is negative, as is the case for Standard Mail Flats, volume growth will necessarily increase the aggregate contribution shortfall. But what did improve for Standard Mail Flats in FY 2016 was the unit contribution, which rose from negative 9.9 cents per piece to negative 9.5 cents per piece. Despite this, however, the cost coverage declined slightly, from 80.3 percent to 79.7 percent.²³ The Postal Service continues to pursue additional process, workflow, and work method improvements to increase efficiency, as discussed in the immediately preceding section of this report.

2. Workshare Discounts and Passthroughs

In FY 2016 20 out of 71 Standard Mail passthroughs exceeded 100 percent. This total compares favorably to FY 2015, when 24 out of 71 Standard Mail passthroughs exceeded 100 percent. The reduction in the number of Standard Mail passthroughs exceeding 100 percent occurred despite the fact that the only market-dominant price adjustment in FY 2016 was the rollback of exigent prices.

i. Letters

Six workshare passthroughs for Standard Mail Letters exceeded 100 percent: Automation AADC Letters, Nonautomation 3-Digit Nonmachinable Letters, Nonautomation 5-Digit Nonmachinable Letters, DNDC Dropship Letters, DCSF Dropship Letters, and Automation Mixed AADC Barcoding.

²³ Normally, when a decline in unit costs exceeds the corresponding decline in unit revenue (thereby improving unit contribution), one would expect the cost coverage to rise, but when both the starting and ending unit contributions are negative, that is not always the case, as proven in this instance.

Pre-Barcoding: Automation Mixed AADC Letters

The Automation Mixed AADC Letters passthrough is 800 percent for FY 2016 compared to 325 percent in FY 2015. The cost avoidance decreased from 1.8 cents in FY 2011 to negative 0.3 cents in FY 2012, increased to 0.2 cents in FY 2013, decreased to 0.1 cents in FY 2014, and increased to 0.4 cents in FY 2015. The FY 2016 cost avoidance fell to 0.2 cents. This barcoding discount encourages mailers to provide an Intelligent Mail barcode (IMb) on their mailpieces, which improves operational efficiency.²⁴ Accordingly, the Postal Service justifies this passthrough pursuant to section 3622(e)(2)(D). Given the historic volatility in the cost avoidance, the Postal Service will endeavor to eliminate the portion of the discount above the avoided cost, in future general market-dominant rate adjustments, taking into consideration other operational and business needs.

Automation AADC Letters

The Automation AADC Letters passthrough is 121.4 percent for FY 2016. This represents a decrease from 140 percent in FY 2015. The cost avoidance decreased from 2.1 cents in FY 2012 to 1.5 cents in FY 2013, increased to 1.6 cents in FY 2014, decreased to 1.5 cents in FY 2015, and decreased to 1.4 cents in FY 2016. Adjusting the Automation AADC letter price to bring the passthrough down to 100 percent would require price increases as high as 8.7 percent, which could result in rate shock for mailers in this price category. The Postal Service acknowledges that the passthrough can also be reduced by lowering the price of the benchmark instead of increasing the price of Automation AADC letters. The Postal Service does not favor this approach,

²⁴ See 39 U.S.C. § 3622(c)(13).

however, as lowering the price of the benchmark would send an inefficient price signal to mailers by reducing their incentive to presort their mail. Accordingly, the Postal Service justifies this passthrough pursuant to section 3622(e)(2)(B). The Postal Service intends to reduce this passthrough in the next general market-dominant rate adjustment, taking into consideration other operational and business needs.

Nonautomation 3-Digit Nonmachinable Letters

The Nonautomation 3-Digit Nonmachinable Letters passthrough is 113 percent, unchanged from FY 2015. The cost avoidance increased from 2.5 cents in FY 2011 to 2.7 cents in FY 2012, decreased to 2.1 cents in FY 2013, increased to 2.6 cents in FY 2014, decreased to 2.3 cents in FY 2015, and remained at 2.3 cents in FY 2016. The price approved for this letter category in Docket No. R2017-1 will reduce the discount from 2.6 cents to 2.5 cents, thereby reducing the passthrough to 108.7 percent. Since the Postal Service has taken action to reduce this passthrough very nearly to 100 percent, and since no statutory exception exists to address actions taken in the general market-dominant price adjustment filed before the ACR, the Postal Service is unable to justifying this passthrough pursuant to 3622(e)(2). Nevertheless, the Postal Service intends to reduce this passthrough to 100 percent during the next general market-dominant price adjustment, or to cite to a statutory exception at that time, taking into consideration other business and operational needs.

Nonautomation 5-Digit Nonmachinable Letters

The Nonautomation 5-Digit Nonmachinable Letters passthrough is 125.4 percent, up from 123.6 percent in FY 2015. The cost avoidance increased from 7.6 cents in FY 2011 to 7.7 cents in FY 2012, decreased to 6.9 cents in 2013, decreased to 6.5 cents in

FY 2014, increased to 7.2 cents in FY 2015, and fell to 7.1 cents in FY 2016. The price approved for this letter category in Docket No. R2017-1 will reduce the discount from 8.9 cents to 8.7 cents, thereby reducing the passthrough to 122.5 percent. However, adjusting the Nonautomation 5-Digit letter price to bring the passthrough down to 100 percent would require a price increase as high as 4.3 percent, which could result in rate shock for mailers in this price category. The Postal Service acknowledges that the passthrough can also be reduced by lowering the price of the benchmark instead of increasing the price of Nonautomation 5-Digit letters. The Postal Service does not favor this approach, however, as lowering the price of the benchmark would send an inefficient price signal to mailers by reducing their incentive to presort their mail. Accordingly, the Postal Service justifies this passthrough pursuant to section 3622(e)(2)(B). The Postal Service intends to reduce this passthrough in the next general market-dominant price adjustment, or to cite to a statutory exception at that time, taking into consideration other business and operational needs.

Dropship Discounts

Two passthroughs for the Dropship Discounts for Letters exceed 100 percent. The passthrough for DNDC letters was 191.3 percent and the passthrough for DSCF letters was 175 percent. These percentages compare favorably to the 225 percent passthroughs that were reported last year. In Docket No. R2017-1, the Postal Service dropped the discount for DNDC letters from 0.35 to 0.26 and dropped the discount for DSCF letters from 0.44 to 0.35. Reducing these discounts will further improve these passthroughs when the prices become effective in FY 2017. However, aligning these discounts with their avoided costs at one time would result in a price increase as large

as 10.1 percent, which could result in rate shock for the mailers in these price categories. Accordingly, the Postal Service justifies these passthroughs pursuant to section 3622(e)(2)(B). Additionally, in Docket No. R2017-1, the Postal Service committed to, and the Commission approved, a plan to reduce these passthroughs by at least 10 percentage points (e.g., from 175 percent to 165 percent) in subsequent general market-dominant price adjustments.²⁵

ii. Flats

Four presorting passthroughs for Standard Mail Flats exceed 100 percent: the presorting Automation FSS Other passthrough, the presorting Automation FSS Scheme passthrough, the pre-barcoding Automation Mixed ADC Flats passthrough, and the presorting Nonautomation FSS Other passthrough.

Automation FSS Other Flats

The presorting Automation FSS Other Flats passthrough is 176.62 percent. This reflects a discount of 13.6 cents exceeding the avoided cost of 7.7 cents. In Docket No. R2017-1 the Postal Service eliminated these price cells. The flats pieces previously occupying the eliminated price cells will be moved to the 3 Digit, 5 Digit, and Carrier Route categories. The Postal Service does not believe that a statutory justification for this passthrough is needed, as it will no longer exist when the rates approved in Docket No. R2017-1 become effective in January of 2017.

²⁵ Docket No. R2017-1, Order No. 3610 - Order on Price Adjustments for First-Class Mail, Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, at 38 (November 15, 2016).

Automation FSS Scheme Flats

The presorting Automation FSS Scheme Flats passthrough is 333.3 percent. This reflects a discount of 3.0 cents exceeding avoided costs of 0.9 cents. In Docket No. R2017-1 the Postal Service eliminated these price cells. The flats pieces previously occupying the eliminated price cells will be moved to the 3 Digit, 5 Digit, and Carrier Route categories. The Postal Service does not believe that a statutory justification for this passthrough is needed, as it will not exist when the rates approved in Docket No. R2017-1 become effective in January of 2017.

Pre-barcoding Automation Mixed ADC Flats

The pre-barcoding Automation Mixed ADC Flats passthrough is 241.2 percent, down from 273.3 percent in FY 2017. This reflects a discount of 4.1 cents exceeding an avoided cost of 1.7 cents. This barcoding discount encourages mailers to provide an Intelligent Mail barcode (IMb) on their mailpieces, which improves operational efficiency.²⁶ Accordingly, the Postal Service justifies this passthrough pursuant to section 3622(e)(2)(D). The Postal Service will reduce the passthrough in the next general market-dominant price adjustment, or cite to a statutory exception at that time, taking into consideration other business and operational needs.

Nonautomation FSS Other Flats

The presorting Nonautomation FSS Other Flats passthrough is 175.0 percent. This reflects a discount of 8.4 cents exceeding avoided costs of 4.8 cents. In Docket No. R2017-1 the Postal Service eliminated these price cells. The flats pieces previously occupying these price cells will be moving to the 3 Digit, 5 Digit, and Carrier Route

²⁶ See 39 U.S.C. § 3622(c)(13).

categories. The Postal Service does not believe that a statutory justification for this passthrough is needed, as it will not exist when the rates approved in Docket No. R2017-1 become effective in January of 2017.

iii. Parcels

Five Standard Mail Parcels passthroughs exceed 100 percent: the presorting NDC Irregular Parcels passthrough, the presorting NDC Marketing Parcels passthrough, the pre-barcoding Mixed NDC Machinable Barcoded Parcels passthrough, the pre-barcoding Mixed NDC Irregular Barcoded Parcels passthrough, and the pre-barcoding NDC Marketing Barcoded Parcels passthrough.

NDC Irregular Parcels

The presorting passthrough for NDC Irregular Parcels is 133.6 percent, down from 160.4 percent in FY 2015. In Docket No. R2017-1, the Postal Service decreased the discount for these parcels from 33.4 cents to 26.3 cents. This will reduce the passthrough from 133.6 percent to 105.2 percent when the prices become effective in January of 2017. Since the Postal Service has taken action to reduce this passthrough very nearly to 100 percent, and since no statutory exception exists to address actions taken in the general market-dominant price adjustment filed before the ACR, the Postal Service is unable to justifying this passthrough pursuant to 3622(e)(2). The Postal Service intends to reduce this passthrough to 100 percent during the next general market-dominant price adjustment, or to cite to a statutory exception at that time, taking into consideration other business and operational needs.

NDC Marketing Parcels

The presorting passthrough for NDC Marketing Parcels is 115.9 percent, down from 135.2 percent in the ACR for FY 2015. In Docket No. R2017-1, the Postal Service reduced the discount from 40.1 cents to 33.4 cents. Since the cost avoidance is now 34.6 cents, the discount will no longer exceed the avoided cost when the R2017-1 prices become effective in January of 2017. Since the Postal Service has already taken appropriate action to reduce this passthrough to 100 percent, and since no statutory exception exists to address actions taken in the general market-dominant price adjustment filed before the ACR, the Postal Service is unable to justifying this passthrough pursuant to 3622(e)(2).

Mixed NDC Machinable Barcoded Parcels

The pre-barcoding passthroughs for Mixed NDC Machinable Barcoded Parcels, Mixed NDC Irregular Barcoded Parcels, and NDC Marketing Barcoded Parcels are 164.9 percent, down from 168.4 percent in FY 2015. As discussed in previous price adjustment filings and ACRs, the nonbarcoded surcharge encourages mailers to develop a fully barcoded parcels mailstream. A fully barcoded mailstream would permit the elimination of keying stations on parcel sorters, thereby increasing the efficiency of postal operations. In light of the above, it makes sense, in the near term, to maintain the pre-barcoding discounts above 100 percent of avoided costs. The Postal Service therefore justifies these passthroughs pursuant to section 3622(e)(2)(D). Additionally, in Docket No. R2017-1, the Postal Service committed to, and the Commission approved, a

plan to reduce these passthroughs by at least 10 percentage points (e.g., from 175 percent to 165 percent) in subsequent general market-dominant price adjustments.²⁷

iv. Carrier Route

Two Carrier Route dropship discounts exceeded their cost avoidances in FY 2016: DNDC entry compared to origin entry and DSCF entry compared to origin entry.

Carrier Route Letters DNDC Entry

Carrier Route Letters with DNDC entry had a passthrough of 160 percent in FY 2016. This compares favorably to last year's passthrough, which was 206.3 percent. Though the Postal Service has made significant progress toward aligning this discount with its avoided cost, adjusting the price of DNDC letters to reduce the passthrough to 100 percent at one time could result in a price increase as high as 4.8 percent. Such a significant price increase could result in rate shock for the mailers in this price category. The Postal Service acknowledges that the passthrough can also be reduced by lowering the price of the benchmark instead of increasing the price of DNDC letters. The Postal Service does not favor this approach, however, as lowering the price of the benchmark would send an inefficient price signal to mailers by reducing their incentive to enter their mail at the DNDC. Accordingly, the Postal Service justifies this passthrough pursuant to section 3622(e)(2)(B). The Postal Service intends to reduce this passthrough in the next general market-dominant price adjustment, or to cite to a statutory exception at that time, taking into consideration other business and operational needs.

²⁷ Docket No. R2017-1, Order No. 3610 - Order on Price Adjustments for First-Class Mail, Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, at 38 (November 15, 2016).

Carrier Route Letters DSCF Entry

Carrier Route Letters with DSCF entry had a passthrough of 187 percent in FY 2016. This reflects a discount of 4.3 cents and a cost avoidance of 2.3 cents. In FY 2015, Carrier Route Letters had a passthrough of 220 percent. Though the Postal Service has made significant progress toward aligning this discount with its avoided cost, adjusting the price of DSCF letters to reduce the passthrough to 100 percent at one time would require a price increase as large as 8.2 percent. Such a significant price increase could result in rate shock for the mailers in this price category. The Postal Service acknowledges that the passthrough can also be reduced by lowering the price of the benchmark instead of increasing the price of DSCF letters. The Postal Service does not favor this approach, however, as lowering the price of the benchmark would send an inefficient price signal to mailers by reducing their incentive to enter their mail at the DSCF. Accordingly, the Postal Service justifies this passthrough pursuant to section 3622(e)(2)(B). The Postal Service intends to reduce this passthrough in the next general market-dominant price adjustment, or to cite to a statutory exception at that time, taking into consideration other business and operational needs.

v. High Density and Saturation Letters, Flats, and Parcels

Two dropship discounts associated with High Density and Saturation Letters, and High Density and Saturation Flats/Parcels, exceeded avoided costs in FY 2016: DNDC Letters compared to origin entry and DSCF Letters compared to origin entry.

DNDC Letters

The passthrough for DNDC Letters compared to Origin Letters is 160 percent for FY 2016. This compares favorably to the passthrough in FY 2015, which was 206.3

percent. Lowering the passthrough to 100 percent by increasing the DNDC prices would require a price increase as high as 7.4 percent. Such a significant price increase could result in rate shock for the users of this price category. The Postal Service acknowledges that the passthrough can also be reduced by lowering the price of the benchmark instead of increasing the price of DNDC letters. The Postal Service does not favor this approach, however, as lowering the price of the benchmark would send an inefficient price signal to mailers by reducing their incentive to enter their mail at the DNDC. Accordingly, the Postal Service justifies this passthrough pursuant to section 3622(e)(2)(B). The Postal Service intends to reduce this passthrough in the next general market-dominant price adjustment, or to cite to a statutory exception at that time, taking into consideration other business and operational needs.

DSCF Letters

The passthrough for DSCF Letters compared to Origin Letters is 187 percent for FY 2016. This is an improvement over the FY 2015 passthrough for this category, which was 225 percent. However, lowering this passthrough to 100 percent by increasing the DNDC prices would require a price adjustment as high as 14 percent. Such a significant price increase could result in rate shock for the mailers in this price category. The Postal Service acknowledges that the passthrough can also be reduced by lowering the price of the benchmark instead of increasing the price of DSCF letters. The Postal Service does not favor this approach, however, as lowering the price of the benchmark would send an inefficient price signal to mailers by reducing their incentive to enter their mail at the DSCF. Accordingly, the Postal Service justifies this passthrough pursuant to section 3622(e)(2)(B). The Postal Service intends to reduce

this passthrough in the next general market-dominant price adjustment, or to cite to a statutory exception at that time, taking into consideration other business and operational needs.

3. Standard Mail Promotions

The six promotions discussed below were in effect for Standard Mail in FY 2016. The Advanced and Emerging Technology Promotion, and the Mail Drives Mobile Engagement Promotion, were offered in calendar year 2015. The Emerging and Advanced Technology/Video in Print Promotion; the Tactile, Sensory and Interactive Mailpiece Engagement Promotion; the Earned Value Reply Mail Promotion; and the Mobile Shopping Promotion were offered in calendar year 2016.

Advanced and Emerging Technology Promotion

A description of the Advanced and Emerging Technology Promotion (June 1 to November 30, 2015) is provided in section II.A.3., above. Between October 1 and November 30, 2015, the Postal Service issued approximately \$6.2 million in discounts for roughly 1.5 billion Standard Mail pieces.

Mail Drives Mobile Engagement Promotion

The Mail Drives Mobile Engagement Promotion (July 1 to December 31, 2015) provided participating mailers an upfront two-percent postage discount on regular and nonprofit Standard Mail letters and flats. To qualify, mailpieces were required to feature mobile print technology that allowed the recipient to purchase a product or interact with the printed mailpiece via his or her mobile phone. Between October 1 and December 31, 2015, the Postal Service issued approximately \$18 million in discounts for roughly 3.6 billion Standard Mail pieces.

Emerging and Advanced Technology/Video in Print Promotion

A description of the Emerging and Advanced Technology/Video in Print Promotion (March 1 to August 31, 2016) is provided in section II.A.3., above. Over the course of the program, the Postal Service issued approximately \$17.8 million in discounts for roughly 4.3 billion Standard Mail pieces.

Tactile, Sensory and Interactive Mailpiece Engagement Promotion

The Tactile, Sensory and Interactive Mailpiece Engagement Promotion (March 1 to August 31, 2016) provided participating mailers an upfront two-percent postage discount on regular and nonprofit Standard Mail letters and flats. To qualify, mailpieces were required to feature advanced print innovations such as developments in paper and stock, substrates, finishing techniques, and inks. In 2015, advanced print technology was included as a qualifying category in the Advanced and Emerging Technology Promotion, and then was separated into its own promotion in 2016. Over the course of the 2016 promotion, the Postal Service issued approximately \$6.3 million in discounts for roughly 1.5 billion Standard Mail pieces.

Earned Value Reply Mail Promotion

A description of the Earned Value Reply Mail Promotion (April 1 to June 30, 2016) is provided in section II.A.3., above. Over the course of the program, the Postal Service issued approximately \$10.5 million in credits for roughly 454 million BRM and CRM pieces. To date, approximately \$2.2 million worth of credits have been used on Standard Mail.

Mobile Shopping Promotion

The Mobile Shopping Promotion (July 1 to December 31, 2016) provides participating mailers an upfront two-percent postage discount on regular and nonprofit Standard Mail letters and flats. To qualify, mailpieces are required to feature mobile technology (such as an open-sourced barcode, a proprietary barcode or tag, or a digital watermark) that connects customers to either a mobile-optimized shopping site, or a social media webpage with a click-to-shop feature. As of September 30, 2016, the Postal Service issued approximately \$13 million in discounts for roughly 2.7 billion Standard Mail pieces.

C. Periodicals

1. Cost, Revenues, and Volumes

Costs, revenues, and volumes for Periodicals products appear below.

Table 4: Periodicals Volume, Revenue, and Cost by Product								
Product	Volume (Million)	Revenue (\$Million)	Volume Variable and Product Specific Costs (\$Million)	Contri- bution (\$Million)	Revenue / Piece (\$)	Cost / Piece (\$)	Unit Contri- bution (\$)	Cost Cover age (%)
In-County Periodicals	534	\$61.0	\$87.0	\$(26.0)	\$0.114	\$0.163	\$(0.049)	70.07
Outside County Periodicals	5,052	\$1,437.8	\$1,950.2	\$(512.4)	\$0.285	\$0.386	\$(0.101)	73.73
Fees		\$7.9	-	-	-	-	-	-
Total Periodicals (incl.fees)	5,586	\$1,506.7	\$2,037.2	\$(530.5)	\$0.270	\$0.365	\$(0.095)	73.96

As shown above, both Periodicals products failed to cover their costs in FY 2016. Cost coverages for the Periodicals class overall decreased from FY 2015 levels, from 75.64 percent to 73.96 percent. The cost coverage of In-County Periodicals decreased from 74.49 percent to 70.07 percent. The cost coverage of Outside County Periodicals declined from 75.30 percent to 73.73 percent.

When examining the Periodicals cost coverage, it is important to note that both cost and revenue play a role in this calculation. In this instance, the revenue per piece for Periodicals as a whole slightly decreased from 27.2 cents in FY 2015 to 27.0 cents in FY 2016, or 0.74 percent. However, at the same time, cost per piece slightly increased to 36.5 cents from 36.0 cents, or 1.4 percent. The combination of these factors led to the FY 2016 decline in cost coverage.

Certain operational changes made in FY 2016 to address flats processing and efficiency (both for Standard Mail and Periodicals) are discussed in Section II.B.1.ii of this Report.

2. Workshare Discounts and Passthroughs

The Saturation and 3-Digit Automation Letters presort discounts were the only discounts in the In-County Periodicals product that were above 100 percent of avoided costs.

Eleven workshare discounts associated with Outside County Periodicals exceeded 100 percent of avoided costs. These include the presort discounts for Machinable Nonautomation 5-Digit Flats, Saturation, Machinable Automation FSS Flats, Machinable Automation 5-Digit Flats, Nonmachinable Nonautomation 3-Digit/SCF Flats, Nonmachinable Nonautomation 5-Digit Flats, Nonmachinable Automation 3-Digit/SCF Flats, Nonmachinable Automation 5-Digit Flats, ADC Automation Letters, 3-Digit Automation Letters, and 5-Digit Automation Letters. The Postal Service justifies all of these discounts pursuant to section 3622(e)(2)(C), which permits discounts provided in connection with mail matter of educational, cultural, scientific, or informational value to exceed 100 percent of avoided costs.

3. FY 2015 ACD Directives

In the FY 2015 ACD, the Commission directed the Postal Service to submit a report addressing the following topics relating to Periodicals pricing:

- a) Whether the 5-Digit, Carrier Route, and FSS workshare discounts are the proper economic incentives and send efficient pricing signals to mailers;
- b) The cost, contribution, and revenue impact of the pricing changes made by the Postal Service in FY 2015;
- c) A detailed quantitative analysis of the progress made in leveraging the Postal Service's pricing flexibility to improve the efficiency of Periodicals pricing in FY 2015; and
- d) Identification of any obstacles to providing the requested analysis as well as the Postal Service's strategy and timeframe for addressing those obstacles.²⁸

That report was filed on July 26, 2016.²⁹ The FY 2015 ACD directive also asked the Postal Service to include an updated version of the Periodicals pricing report with this ACR.³⁰ USPS-FY16-44 responds to that portion of the directive by updating the information provided in response to topics a through d identified above.

In the FY 2015 ACD, the Commission also directed the Postal Service to submit a detailed report addressing the measurement of cost and service performance issues for flat-shaped products (including Periodicals and Standard Mail), with specific

²⁸ Annual Compliance Determination Report: Fiscal Year 2015, PRC Docket No. ACR2015 (Mar. 28, 2016), at 23-24. This new directive superceded a directive that had been included in the 2014 ACD, requiring the Postal Service to provide in the FY 2015 ACR "a detailed analysis of the cost and contribution impact of the worksharing incentives offered for 5-Digit and Carrier Route presortation" and "a report on its progress in improving Periodicals pricing efficiency." *See* Annual Compliance Determination Report: Fiscal Year 2014, PRC Docket No. ACR2014 (Mar. 27, 2015), at 16-17.

²⁹ Third Response of the United States Postal Service to Commission Request for Additional Information in the FY 2015 Annual Compliance Determination, PRC Docket No. ACR2015 (Jul. 26, 2016).

³⁰ Annual Compliance Determination Report: Fiscal Year 2015, PRC Docket No. ACR2015 (March 28, 2016), at 24.

reference to six identified “pinch points.”³¹ The Postal Service’s initial report addressing flats issues was filed on July 26, 2016.³² In response to a Commission Information Request addressing the report, and following a technical conference held on October 21, 2016, the Postal Service provided additional information addressing, where possible, methods or plans by which certain cost and service performance issues for each of the six pinch points described in the FY 2016 ACD directive might be measured, tracked, and recorded going forward.³³

D. Package Services

1. Cost, Revenues, and Volumes

Costs, revenues, and volumes for Package Services products appear below.

Table 5: Package Services Volume, Revenue and Cost by Product

Product	Volume (Million)	Revenue (\$Million)	Volume Variable & Product Specific Costs (\$Million)	Contribution (\$Million)	Revenue / Piece (\$)	Cost / Piece (\$)	Unit Contribution (\$)	Cost Coverage (%)
Bound Printed Matter Flats	264.9	208.6	130.6	78.0	0.787	0.493	0.295	159.76
Bound Printed Matter Parcels	250.0	288.7	276.9	11.8	1.155	1.108	0.047	104.27
Media Mail/ Library Mail	75.0	266.4	354.3	(87.9)	3.552	4.725	(1.173)	75.18
Alaska Bypass	1.3	33.5	19.7	13.8	26.148	15.377	10.771	170.04
Fees		2.2						
Total Package Services Mail (incl. fees)	591.2	799.4	781.5	17.9	1.352	1.322	0.030	102.29

³¹ FY 2015 ACD at 181-182.

³² Third Response of the United States Postal Service to Commission Request for Additional Information in the FY 2015 Annual Compliance Determination, PRC Docket No. ACR2015 (Jul. 26, 2016).

³³ Response of the United States Postal Service to Commission Information Request No. 1, PRC Docket No. ACR2015 (Nov. 28, 2016).

One Package Services product failed to cover its volume variable and product specific cost. Media Mail/Library Mail had a cost coverage of 75.18 percent, which amounts to a 1.05 percentage point decline from 76.23 percent in FY 2015. While the cost per piece decreased by 7 cents from FY 2015, the revenue per piece decreased by 10.3 cents. The revenue per piece declined as a result of the exigent surcharge rollback in April 2016. The Postal Service's January 2017 general market-dominant rate adjustment (Docket No. R2017-1), the first general market-dominant rate adjustment since May 2015 (Docket No. R2015-4), includes an above-average rate increase for Media Mail/Library Mail. Going forward, the Postal Service intends to improve the cost coverage of Media Mail/Library Mail over time through above-average price increases for this product.

Overall, the class had a cost coverage of 102.29 percent, declining from a cost coverage of 104.95 percent in FY 2015. Though the cost coverage for Bound Printed Matter (BPM) Flats increased by 19.2 percentage points to 159.76 percent, the decline in cost coverage seen in all other products was too significant to overcome, resulting in the lower overall cost coverage for the class. This overall decline in cost coverage is largely due to the cost coverage decline for BPM Parcels, which fell from 118.72 percent in FY 2015, to 104.27 percent for FY 2016. The decline in cost coverage for this product is due to an increase in costs of 6 cents per piece, and a corresponding decrease in revenue of 8.9 cents per piece. The overall variable costs for BPM Parcels increased by close to 16 percent, due in part to a volume increase of close to 12 percent. The increase in overall revenue was limited by the exigent surcharge rollback.

2. Workshare Discounts and Passthroughs

i. Media Mail / Library Mail

Two passthroughs associated with Media Mail/Library Mail exceeded 100 percent in FY 2016: the Media Mail Basic presort passthrough and the Library Mail Basic presort passthrough. The former is 112.6 percent (discount of 25 cents compared to the cost avoidance of 22.2 cents), and the latter is 108.1 percent (discount of 24 cents compared to the cost avoidance of 22.2 cents). Each represents a decrease, from 125.6 percent and 120.9 percent, respectively, compared to FY 2015. The Postal Service justifies these passthroughs pursuant to section 3622(e)(2)(C), as Media Mail and Library Mail transport matter of educational, cultural, scientific, and informational value. The Postal Service notes that in ACDs for prior fiscal years, the Commission found higher passthroughs to be justified under section 3622(e)(2)(C).³⁴ Moreover, with the Commission's approval of the prices filed in Docket No. R2017-1, these passthroughs will fall below 100 percent in January 2017.

ii. BPM Flats and BPM Parcels

Seven passthroughs for BPM Flats and BPM Parcels exceeded 100 percent in FY 2016. In the Postal Service's last general market-dominant rate adjustment, approved in Docket No. R2015-4, the Postal Service set all passthroughs for BPM Flats and BPM Parcels as close to 100 percent, or lower, as possible. With respect to those discounts for it was not possible for the passthrough to reach 100 percent or lower, the

³⁴ The Media Mail Basic presort passthrough was 125.6 percent in FY 2015, and 175.0 percent in FY 2014. The Library Mail Basic presort passthrough was 120.9 percent in FY 2015, and 167.9 percent in FY 2014.

Commission accepted the Postal Services explanations and justifications.³⁵ Since that price change, two fiscal years' of new cost avoidance data have become available, as presented in the ACR filed for FY 2015 and in this ACR. The impact of the changes in cost avoidances on these passthroughs since the Postal Service set prices in Docket No. R2015-4 is discussed below.

BPM Flats and BPM Parcels DNDC Dropship

The passthroughs for the BPM Flats and BPM Parcels DNDC dropship discounts are both 113.7 percent for FY 2016 (discounts of 11.6 cents compared to cost avoidances of 10.2 cents), up slightly from 111.5 percent in FY 2015, due to a decrease in the cost avoidance. In Docket No. R2013-10, the Postal Service reduced these discounts to align with the FY 2012 cost avoidance of 14.1 cents. In FY 2014, the cost avoidance dropped to 11.6 cents, and the Postal Service responded by again aligning the workshare discounts with avoided costs in Docket No. R2015-4. Since then, however, the cost avoidance dropped even further, to 10.4 cents for FY 2015, and 10.2 cents for FY 2016, for a total decrease of 1.4 cents, or 12.1 percent.

Cost avoidances for each fiscal year are estimated after the end of that fiscal year. Because there is no statutory exception to address the structural lag between the estimation of new cost avoidances and pre-existing discounts, the Postal Service is not relying on any statutory worksharing exception to justify these discounts, which were set in Docket No. R2015-4 using FY 2014 cost avoidance data. Moreover, with the Commission's recent approval of the prices filed in Docket No. R2017-1, these passthroughs will improve in January 2017, to 110.8 percent using FY 2016 cost

³⁵ Order No. 2472, Order on Revised Price Adjustments for Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, Docket No. R2015-4 (May 7, 2015), at 60.

avoidance data.³⁶ Barring further large swings in cost avoidance, the Postal Service intends to adjust these discounts to reflect the most recent cost avoidance data during the next general market-dominant price change, or cite to a statutory exception at that time, taking into consideration other business and operational needs.

BPM Flats and BPM Parcels DSCF Dropship

The passthrough for the BPM Flats DSCF dropship discount is 106.4 percent (discount of 58.3 cents compared to the cost avoidance of 54.8 cents), and the passthrough for the BPM Parcels DSCF dropship discount is 110.6 percent (discount of 60.6 cents compared to the cost avoidance of 54.8 cents). Each passthrough represents a decrease, from 110.7 percent and 115.1 percent, respectively, compared to FY 2015. In Docket No. R2013-10, each of these discounts were set below the FY 2012 cost avoidance of 64.8 cents. In FY 2014, the cost avoidance dropped to 58.3 cents, and in Docket No. R2015-4, the Postal Service responded by reducing the discounts to 58.3 cents for flats, and 60.6 cents for parcels. The Commission found that the parcels discount, which resulted in a passthrough of 103.9 percent based on the FY 2014 cost avoidance data, was justified under section 3622(e)(2)(B) (rate shock) and section 3622(e)(2)(D) (efficient operation of the Postal Service).³⁷ Since then, however, the cost avoidance has dropped further, to 54.9 cents for FY 2015, and 54.8 cents for FY 2016, for a total decrease of 3.5 cents, or 6 percent.

³⁶ The Commission found the BPM Flats and BPM Parcels DNDC dropship discounts filed in Docket No. R2017-1, for implementation in January 2017, to be justified under section 3622(e)(2)(B) (rate shock). In that docket, the passthroughs were calculated based on FY 2015 cost avoidance data. Order No. 3610, Order on Price Adjustments for First-Class Mail, Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, Docket No. R2017-1 (Nov. 15, 2016), at 53-55.

³⁷ Order No. 2472 at 60.

Cost avoidances for each fiscal year are estimated after the end of that fiscal year. Because there is no statutory exception to address the structural lag between the estimation of new cost avoidances and pre-existing discounts, the Postal Service is not relying on any statutory work-sharing exception to justify these discounts, which were set in Docket No. R2015-4, using FY 2015 avoided cost data. The Postal Service intends to adjust these discounts to match the most currently available cost avoidance data during the next general market-dominant price change, or cite to a statutory exception at that time, taking into consideration other business and operational needs.³⁸

BPM Flats DFSS Dropship

The passthrough for the BPM Flats DFSS dropship discount is 108.2 percent (discount of 59.3 cents compared to the cost avoidance of 54.8 cents), down from 112.2 percent in FY 2015. With the Commission's approval of the structural changes filed in Docket No. R2017-1, the Postal Service is eliminating all FSS price categories for flat-shaped pieces beginning January 2017; therefore, the BPM Flats DFSS dropship discount will no longer be available.

BPM Flats and BPM Parcels DDU Dropship

The passthrough for the BPM Flats DDU dropship discount is 106.5 percent (discount of 75.1 cents compared to the cost avoidance of 70.5 cents), and the passthrough for the BPM Parcels DDU dropship discount is 111.1 percent (discount of 78.3 cents compared to the cost avoidance of 70.5 cents). Each passthrough represents a decrease, from 111.7 percent and 115.9 percent, respectively, compared

³⁸ The Commission found the BPM Flats and BPM Parcels DSCF dropship discounts filed in Docket No. R2017-1, for implementation in January 2017, to be justified under section 3622(e)(2)(B) (rate shock). Order No. 3610 at 53-55.

to FY 2015. In Docket No. R2013-10, each of these discounts was set at 79.1 cents, in alignment with the FY 2012 avoided costs. In FY 2014, the cost avoidance dropped to 75.1 cents, and the Postal Service correspondingly reduced the discounts in Docket No. R2015-4 to 75.1 cents for flats, and 78.3 cents for parcels. The Commission found that the parcels discount, which resulted in a passthrough of 104.3 percent based on the FY 2014 cost avoidance data, was justified under section 3622(e)(2)(B) (rate shock) and section 3622(e)(2)(D) (efficient operation of the Postal Service).³⁹ Since then, however, the FY 2015 cost avoidance decreased to 69.8 cents, and then increased slightly to 70.5 cents for FY 2016, for an overall decrease of 4.6 cents, or 6.1 percent.

Cost avoidances for each fiscal year are estimated after the end of that fiscal year. Because there is no statutory exception to address the structural lag between the estimation of new cost avoidances and pre-existing discounts, the Postal Service is not relying on any statutory worksharing exception to justify these discounts, which were set in Docket No. R2015-4, using FY 2014 avoided cost data. With the Commission's approval of the prices filed in Docket No. R2017-1, these passthroughs will improve in January 2017, to 106.4 percent for flats, and 107.5 percent for parcels, using FY 2016 cost avoidance data.⁴⁰ The Postal Service intends to adjust these discounts to match the most currently known cost avoidance data during the next general market-dominant price change, or cite to a statutory exception at that time, taking into consideration other business and operational needs.

³⁹ Order No. 2472 at 60.

⁴⁰ The Commission found the BPM Flats and BPM Parcels DDU dropship discounts filed in Docket No. R2017-1, for implementation in January 2017, to be justified under section 3622(e)(2)(B) (rate shock). Order No. 3610 at 53-55.

E. Special Services

1. Cost, Revenues, and Volumes

Costs, revenues, and volumes for Special Services appear below.

Table 6: Special Services Volume, Revenue and Cost by Service/Product								
Service/Product	Volume (Million)	Revenue (\$Million)	Volume Variable and Product Specific Costs (\$Million)	Contribution (\$Million)	Revenue / Piece (\$)	Cost / Piece (\$)	Unit Contri- bution (\$)	Cost Coverage
Certified Mail	197.8	670.5	521.1	149.4	3.39	2.63	0.76	128.67%
COD	0.2	2.0	4.9	(2.9)	10.07	24.51	(14.45)	41.07%
Insurance	15.3	76.9	42.8	34.1	5.01	2.79	2.22	179.59%
Registered Mail	2.0	31.6	16.3	15.4	15.72	8.07	7.64	194.67%
Stamped Envelopes	N/A	9.1	9.5	(0.4)	N/A	N/A	N/A	95.49%
Stamped Cards	N/A	0.6	0.3	0.4	N/A	N/A	N/A	238.77%
Other Ancillary Services	N/A	447.5	206.8	240.7	N/A	N/A	N/A	216.36%
Total Ancillary Services	N/A	1,238.3	801.7	436.5	N/A	N/A	N/A	154.45%
Int'l Ancillary Services	28.9	43.3	43.7	(0.4)	1.50	1.51	(0.01)	99.16%
Caller Service	N/A	94.4	23.1	71.2	N/A	N/A	N/A	407.73%
Address Management Services	N/A	16.7	6.8	5.3	N/A	N/A	N/A	246.38%
Credit Card Authentication*	16.6	16.9	1.7	15.3	1.02	0.10	0.92	1004.70%
Customized Postage	-	0.0	0.1	(0.1)	N/A	N/A	N/A	14.30%
Money Orders	90.3	156.4	116.7	39.7	1.73	1.29	0.44	133.99%
Post Office Box Service	N/A	284.0	229.6	54.4	N/A	N/A	N/A	123.70%
Stamp Fulfillment Services	N/A	3.7	4.3	(0.5)	N/A	N/A	N/A	87.30%
Total Special Services Mail	N/A	1,853.7	1,227.6	626.0	N/A	N/A	N/A	150.99%

*See USPS-FY16-NP26 for cost adjustments after revenue-sharing with third-party partners.

2. Discussion of Low Cost Coverages

Three special services failed to cover their costs in FY 2016: COD, International Ancillary Services, and Stamp Fulfillment Services. Also, the revenue reported in the

CRA for Stamped Envelopes and Customized Postage do not cover costs, but for the reasons discussed below, the Postal Service nonetheless does not consider either service to be underwater.

Collect on Delivery (COD)

COD had costs of \$4.9 million in FY 2016, but listed revenues of only \$2.0 million, resulting in a cost coverage of 41 percent, falling from the 103 percent cost coverage in FY 2015. Historically, COD costs have varied greatly because the small number of transactions has resulted in limited observations during sampling for costing purposes. In FY 2016, cost increased from \$3.0 million to \$4.9 million, despite a substantial decline in reported transactions. The price of COD was increased in Docket No. R2017-1. The Postal Service believes that a combination of this price increase and different sampling results next year could result in a cost coverage exceeding 100 percent in FY 2017.

International Ancillary Services

International Ancillary Services failed to cover costs by \$400,000 because Inbound Registered Mail lost \$9.8 million in FY 2016 compared to a \$19.5 positive contribution in FY 2015. The loss reflects the costing changes approved in Docket No. RM2016-10, which reassigned delivery costs from Inbound Letter Post to Inbound Registered Mail. Order No. 3621 (November 17, 2016). The Postal Service notes, however, that additional payments for registered items, as set forth in the Universal Postal Convention, are subject to a graduated increase in 2017 under the current Convention text, and Registered Mail terminal dues rates will increase significantly in 2018. See Article 29:8 of the Universal Postal Convention and Article 27 of the Draft

Istanbul Convention. In addition the Postal Service participates in the voluntary supplementary remuneration for inbound registered items, and this too should lead to additional revenue for inbound registered items. It is important to keep in mind that many foreign postal operators participate in the Inbound Market Dominant Registered Service Agreement 1 multilateral agreement, and this creates another separate source of contribution for inbound registered mail, as associated with that agreement.⁴¹

Stamp Fulfillment Services

Stamp Fulfillment Services (SFS) had costs of \$4.3 million in FY 2016, but listed revenues of only \$3.7 million, resulting in a cost coverage of 87 percent. Despite the Exigent fee rollback during FY 2016, the FY 2016 cost coverage is the highest cost coverage for SFS ever. See FY 2015 ACD at 68 (Table III-14). The Postal Service chose not to raise SFS prices as part of Docket No. R2017-1, to see if the Exigent rollback price decrease would result in an increase in volume and revenue. The Postal Service continues to agree with the Commission's comments in the ACD for FY 2012, at 142:

The costs and revenues associated with the SFS product do not entirely capture the value that the Services Center adds to the Postal Service, and to other Postal Service products. Although SFS does not cover its attributable costs, by providing a mechanism for the centralized ordering of stamps, it reduces the costs associated with the retail purchases of stamps. Thus, it promotes the objectives of reducing costs and increasing efficiency. See 39 U.S.C. 3622(b)(1) and (c)(12).

⁴¹ See PRC Order No. 3471, Order Adding Inbound Market Dominant Registered Service Agreement 1 to the Market Dominant Product List and Approving Type 2 Rate Adjustment, Docket Nos. MC2016-168 and R2016-6, August 17, 2016.

Customized Postage

The Postal Service is investigating Customized Postage records to determine if revenue is being underreported for FY 2016. One customer paying the annual participation fee would provide enough revenue to cover costs.

Stamped Envelopes

As discussed in the Postal Service's response to ChIR No. 2, Question 4(c) in Docket No. ACR2015, filed January 15, 2016, Stamped Envelope revenue as reported in the CRA does not include revenue from Personalized Stamped Envelope premium option and shipping fees. When these revenues are added to CRA revenue for Stamped Envelopes, revenue increases to \$13.1 million, resulting in a 137 percent cost coverage. Please see the Stamped Envelope billing determinants in USPS-FY16-4.

F. Negotiated Service Agreements

There was one domestic market dominant Negotiated Service Agreement (NSA) in effect in FY 2016: PHI Acquisitions, Inc. ("Potpourri"). Full information regarding the Potpourri NSA appears in USPS-FY16-30. The Potpourri NSA was implemented in Q4 of FY 2014. There were no acquisition or divestiture activities by PHI during Agreement Year 2, and therefore, no volume and threshold impact. From a fiscal year perspective, Potpourri had FY 2016 NSA volume of 227,868,254 pieces, total after rebate revenue of \$53.8 million, and costs of \$49.2 million, resulting in a cost coverage of 109.4 percent. The volume-based agreement earned a rebate on eligible Standard Mail volume of approximately \$2.215 million during FY2016.

The Commission reviews NSAs from a contract year perspective, and it focuses on the net benefit of an NSA to the Postal Service. As shown in USPS-FY16-30, using the evaluation method preferred by the Postal Service, the net benefit of the Potpourri NSA for the contract year of July 2015 to June 2016 is estimated to be negative \$0.524 million. The PHI Standard Mail weighted average cost per piece is higher than originally modelled in PRC Docket No. MC2014-21. The new weighted average now includes the unit costs specifically estimated for pieces qualifying for Flats Sequencing System (FSS) rate categories. The FSS rate categories were implemented during Agreement Year 1, and new cost models were created in FY2015 to address those changes. In Agreement Year 2, the PHI weighted average per piece cost has increased across the new set of rate categories for which cost estimates are available.

Alternatively, using the Commission's preferred methodology, as also shown in USPS-FY16-30, the net value of the Potpourri NSA to the Postal Service's net financial position over the contract year was negative \$1.349 million. As explained previously, the Postal Service views its preferred net value estimation methodology as better suited than the Commission's for analysis of commercial corporate mailing activity.

Although Agreement Year 2 shows a negative impact to overall contribution, the agreement to date shows a net of over \$726 thousand in positive contribution. Thus, the Postal Service does not anticipate that this Agreement will cause negative impact to the net overall contribution to the institutional costs of the Postal Service over the total term of this Agreement. The scale of the agreement was sufficiently small to make market effects unlikely, and similar functionally-equivalent NSAs could have been made

available to similarly-situated mailers. Thus, the Potpourri NSA satisfies section 3622(c)(10)(A) and the Commission's rules.

III. SERVICE PERFORMANCE, CUSTOMER SATISFACTION, AND CONSUMER ACCESS

A Substantial Service Performance Strides

During FY 2010, the Commission issued its final rules on periodic reporting of service performance measurement and customer satisfaction, which are codified at 39 C.F.R. Part 3055.⁴² Among other things, Commission Rules 3055.20 through 3055.24 require annual reporting of service performance achievements at the national level for all market-dominant products. Reporting, however, is not required where the Commission has granted a semi-permanent exception or a temporary waiver.⁴³ The Postal Service's report, including information responsive to the criteria listed in Rule 3055.2(b)-(k), is included as USPS-FY16-29.⁴⁴

The Postal Service set for itself aggressive on-time targets for all market-dominant products. It has used those high targets to challenge itself to strive for – and achieve – continuous improvement and to provide better service to our customers. For some products and in some districts, these targets have already been met or exceeded. For example, with respect to Special Services during FY 2016, the Postal Service exceeded its on-time target of 90 percent in all but one of the reported categories.⁴⁵

⁴² PRC Order No. 465, Order Establishing Final Rules Concerning Periodic Reporting of Service Performance Measurements and Customer Satisfaction, Docket No. RM2009-11, May 25, 2010.

⁴³ *Id.* at 21-23.

⁴⁴ USPS-FY16-29 also includes a new report on Methodologies for service performance measurement, in compliance with PRC Order No. 3490, Order Enhancing Service Performance Reporting Requirements and Closing Docket, Docket No. PI2016-1, August 26, 2016.

⁴⁵ Even in that one category (P.O. Box Service), performance was only slightly below the targeted 90% mark, achieving 89.7%.

Whether exceeding its high targets or not, during FY 2016 the Postal Service made undeniable improvements almost entirely across the board. In the 16 reported categories for First-Class Mail, the Postal Service made year-over-year improvements in a full 15 of those 16 categories.⁴⁶ Like with First-Class Mail, the Postal Service has achieved its service improvements across a wide swath of its reported categories for other products, too. For example, in the 9 reported categories for Standard Mail, the Postal Service made year-over-year improvements in 8 of those 9 categories. Similarly, the Postal Service improved in both of the 2 separately reported categories for Periodicals. The Postal Service also improved in 2 of the 3 separately reported categories for Package Services. Moreover, even in the third category (Bound Printed Matter Parcels) where there was a slight drop, the Postal Service still achieved over 99 percent (99.2 percent), well in excess of the 90% target. When service quality is that high, there is simply not much more room for improvement within that category.

The Postal Service improved its performance significantly during the course of the year, achieving notable increases in performance for the third and fourth quarters of FY 2016 compared to the first and second quarters. These positive quarterly trends during the year included some of the most voluminous of mail categories. For example, First-Class Mail Single-Piece Letters/Postcards 2-Day improved from 94.5 percent and 94.7 percent to 96.5 percent and 96.3 percent from the first two quarters of the fiscal year to the last two quarters; Standard Mail High Density and Saturation Letters improved from 92.5 percent and 93.8 percent to 96.8 percent and 96.7 percent; and In-

⁴⁶ The only 1 of the 16 First-Class Mail categories that saw a drop from last year was Two-Day Outbound Single-Piece First-Class Mail International. Even with a small decline in that category, it still exceeded a 90% on-time success rate (at 90.6 percent).

County Periodicals improved from 74.3 percent and 78.8 percent to 83.7 percent and 83.7 percent.

Not only have the Postal Service's service improvements been broad across almost all product categories, but its achievements have also been dramatic in magnitude, particularly in certain important categories. For First-Class Mail, the Postal Service's composite performance in FY 2016 is now higher than it was prior to the time that the operating window change was implemented. For Standard Mail, the Postal Service achieved its highest ever annual composite performance, attaining an annual FY 2016 composite performance of 93.0 percent. That was not only the highest annual figure ever achieved, but it also exceeded its target of 91.0 percent by two percentage points. These composite results were driven by great leaps within most component categories. For example, Standard Mail Letters increased from 85.8 percent in FY15 to 90.1 percent in FY 16, and Standard Mail Flats jumped all the way from 73.8 percent last year to 81.4 percent in this one-year span.

For First-Class Mail during FY 2016, the Postal Service achieved four straight quarters of continuous improvement, attaining an annual First-Class Mail composite performance of 93.0 percent. The Postal Service achieved particularly ample one-year improvements in its performance for all reported First-Class Mail services for three-to-five day delivery. Flats were an area of particular concern last year for the Commission. For three-to-five day delivery for First-Class Mail Flats, the Postal Service achieved a year-over-year improvement from 65.3 percent to 70.9 percent. Flats, though, were hardly the only area in which the Postal Service vastly improved its three-to-five day delivery. First-Class Mail Single-Piece Letters/Postcards improved from 77.3 percent

to 84.8 percent ; First-Class Mail Presort Letters/Postcards improved from 88.0 percent to 91.9 percent; First-Class Mail Parcels improved from 73.7 percent to 80.3 percent; Outbound Single-Piece First-Class Mail International improved from 82.5 percent to 84.5 percent; and Inbound Single-Piece First-Class Mail International improved from 71.3 percent to 77.7 percent.

In addition, the amount of commercial mail in official measurement has increased in FY 2016 over FY 2015 and is expected to continue to increase in FY 2017.

Improved performance was evident in the majority of metrics compared to the prior year and reflected improved trends during the course of FY 2016. These measurable improvements in transit time performance were achieved largely through process improvements. We have set stretch targets for FY 2017 and expect to realize continuous improvement in all service metrics.

B. Customer Satisfaction with Market Dominant Products

Section 3652(a)(2)(B)(ii) requires the Postal Service to provide measures of the degree of customer satisfaction with the service provided for its market dominant products, also known as mailing services.

1. Overview

The Customer Engagement and Strategic Alignment (CE&SA) group in Consumer and Industry Affairs at Postal Service Headquarters was responsible for survey measurement of the level of customer satisfaction with market dominant products during FY 2016 for Postal Service customers. Surveys were administered

across all four quarters of the year for three customer groupings – Residential, Small/Medium Business and Large Business customers.

2. Background

The Customer Insights (CI) program, directed by the Consumer and Industry Affairs department, provides a comprehensive view of the customer experience across the most frequently used customer contact channels. CI's modular components and flexible design allow expansion and inclusion of additional points of contact to meet the quickly changing customer landscape. The Postal Service is dedicated to delivering excellent customer experiences and the CI program supports this effort.

Customer Insights Measurement System — The CI measurement system provides a holistic view of customer satisfaction. The customer experience is measured across four touch points then weighted and aggregated to create the CI composite score.

3. Methodology

For the CI system in FY 2016, Residential and Small/Medium business customers were randomly selected, contacted by mail and offered the opportunity to complete an online or phone survey. Residential and Small/Medium businesses are sampled sufficiently to ensure, at the District level, a minimum precision level of +/- 5 percentage points, at the 90 percent level of confidence per postal quarter. In addition, a Large Business Panel Survey (>250 Employees) was conducted in quarter 2 & 4.

To measure customer experience with market dominant products, residential, small business, and large business survey respondents were asked to rate their product satisfaction using a six-point scale: *Very Satisfied, Mostly Satisfied, Somewhat Satisfied, Somewhat Dissatisfied, Mostly Dissatisfied, and Very Dissatisfied*.

Respondents were also given the option of marking “*Don’t Use Product*” and those that responded in this manner were not included in the calculations for satisfaction with market dominant products. Customers who indicated that they did not use a product or were not familiar with a product were excluded from the calculated satisfaction ratings.

In FY 2016, the Postal Service continued combining only the top two box scores of *Very Satisfied* and *Mostly Satisfied*. The scores reported for market dominant products in FY 2016 result from combining only these *Very Satisfied* and *Mostly Satisfied* ratings.

4. Survey Results – FY 2016 Ratings for Market Dominant Products

As it did in the 2015 ACR, the Postal Service presents information below regarding customer satisfaction with Market Dominant Products. Overall, customer

satisfaction increased from FY 2015 to FY 2016, as reflected in the Customer Insight (CI) Composite Score shown below:

National	FY15	FY16	Var
CI Composite	85.73	87.62	1.89
POS	86.28	86.38	0.10
Delivery	77.49	76.26	-1.23
BSN	94.32	95.13	0.81
CCC	76.22	85.18	8.96

In particular, the Postal Service's Customer Care Centers (CCCs) saw a marked increase of 8.96 percent from FY 2015 to FY 2016. Point of Sale (POS) and Business Services Network (BSN) scores also increased from FY 2015 to FY 2016, reflecting the Postal Service's concentrated efforts in this area. The only aspect of the CI Composite that decreased slightly from FY 2015 to FY 2016 was customer satisfaction within the Delivery component.

The chart immediately below shows a breakdown of the Mailing Services customer satisfaction results for market dominant products (FY 2016 vs. FY 2015), a separate portion of the customer satisfaction survey related to the Delivery component in the chart above. Following the chart, the Postal Service analyzes these figures to show where the Postal Service's efforts during FY 2016 were successful and to detail steps it will take in FY 2017 to improve customer satisfaction in this area.

**Customer Satisfaction with Market Dominant Products (Mailing Services) -
FY 2016 (FY 2015)**

Market Dominant Products (Mailing Services)	Residential % Rated Very/Mostly Satisfied	Small/Medium Business % Rated Very/Mostly Satisfied	Large Business % Rated Very/Mostly Satisfied
First-Class Mail	89.13 (89.22)	83.34 (84.77)	81.49 (83.27)
Single-Piece International	84.80 (85.80)	81.34 (82.31)	74.37 (82.65)
Standard Mail	85.49 (85.11)	79.87 (80.82)	76.89 (79.49)
Periodicals	85.07 (85.50)	81.86 (82.42)	74.26 (77.10)
Retail Ground (Single-Piece Standard Post)	86.28 (86.66)	81.13 (82.65)	75.85 (77.81)
Media Mail	86.59 (87.17)	84.05 (85.18)	74.28 (78.61)
Bound Printed Matter	--* (--)	80.11 (81.70)	73.40 (76.54)
Library Mail	85.54 (85.10)	83.05 (85.43)	70.56 (78.66)
*-- Number of responses received did not meet minimum threshold for 90% level of confidence.			

The chart shows slight decreases in FY 2016 in Residential, Small/Medium Business, and Large Business customer satisfaction for most products listed. However, most of these decreases are tenths of a percent. Moreover, as shown below, comparing customer satisfaction results for the first half of FY 2016 with the same scores for the second half of FY 2016 shows that the Postal Service's efforts to improve customer satisfaction among Residential and Small/Medium Business customers

resulted in increases with respect to almost all market dominant products, including First-Class Mail.

**Customer Satisfaction with Market Dominant Products (Mailing Services) -
First Half of FY 2016 vs. Second Half of FY 2016 vs. Total FY 2016**

Market Dominant Products (Mailing Services)	Residential % Rated Very/Mostly Satisfied FY16			Small/Medium Business % Rated Very/Mostly Satisfied FY16			Large Business % Rated Very/Mostly Satisfied FY16		
	Oct – Mar	Apr – Sept	Year Total	Oct – Mar	Apr – Sept	Year Total	May	Sep	Year Total
First-Class Mail	88.50	89.77	89.13	82.62	84.13	83.34	81.89	81.07	81.49
Single-Piece International	85.14	84.42	84.80	81.10	81.61	81.34	74.01	74.73	74.37
Standard Mail	84.92	86.06	85.49	79.03	80.82	79.87	77.87	75.87	76.89
Periodicals	84.45	85.70	85.07	80.87	82.99	81.86	74.50	74.02	74.26
Retail Ground (Single-Piece Standard Post)	85.89	86.69	86.28	79.75	82.77	81.13	75.92	75.79	75.85
Media Mail	86.30	86.90	86.59	83.96	84.17	84.05	75.33	73.20	74.28
Bound Printed Matter	—*	—*	—*	80.06	80.16	80.11	73.12	73.70	73.40
Library Mail	85.60	85.48	85.54	83.09	83.00	83.05	70.71	70.40	70.56
*— Number of responses received did not meet minimum threshold for 90% level of confidence.									

The Postal Service implemented key steps in the second half of FY 2016 that in part have contributed to customer satisfaction improvement. First, management

employed Lean Six Sigma principles to identify ways to maximize service opportunities and correct service problems. This included using employee led teams, where managers and employees collaborate to identify solutions to reoccurring service issues. Second, management created action-oriented dashboards to identify key areas of opportunity for quick resolution. This step enabled operational managers to implement timely solutions as issues arose.

As reflected in the charts above, the Postal Service recognizes that the customer service area most in need of focus for FY 2017 is its Large Business portfolio. Although the vast majority of Large Business customers still report being very or mostly satisfied with the Postal Service's mailing services for all market dominant products, the Postal Service recognizes that it must take steps to increase these numbers. As a first step, management will conduct analytics of all of the customer satisfaction numbers to better understand the key drivers for the current scores. By better understanding the reasons for the current scores, the Postal Service will be able to design and implement customer satisfaction improvements as appropriate. Even prior to review of such analytics, however, the Postal Service is continuing its efforts to improve overall customer satisfaction with mailing services of market dominant products as it did throughout FY 2016. In addition, the Postal Service expects the mitigation plans identified in folder FY16-29 to result in increases in customer satisfaction.

5. Addressing Mail Delivery and Carrier Performance Issues

The Postal Service is sensitive to customer concerns about misdelivery of mail and general letter carrier performance, as indicated in some of the CI survey questions noted in the chart below:

Agreement with ...	Residential			Small Business		
	%Somewhat or Strongly Disagree			%Somewhat or Strongly Disagree		
	FY14	FY15	FY16	FY14	FY15	FY16
2a. Mail or packages are delivered to the correct address	11.20	11.70	12.07	12.90	14.80	15.82
2b. Mail or packages are delivered in good condition	4.80	4.90	4.87	4.70	7.40	5.49
2c. Letter carriers are friendly and courteous	4.10	4.40	4.61	5.60	6.00	6.54
2d. Letter carriers perform their job well	9.30	9.80	10.26	10.70	11.80	13.04
2e. Tracking information for packages is accurate	4.80	5.00	5.52	4.60	5.30	6.07

The Postal Service has undertaken several mitigation efforts in FY 2016 to address these issues, including the following:

- Weekly reports containing data on customer complaints, specifically on misdelivered mail, are sent to field delivery management identifying delivery units and routes with high customer complaints in order to address and improve performance.
- Headquarters Delivery Operations collaborated with the Area Vice Presidents, using data and information on Undeliverable as Addressed scanning events as a means to drive improvement.
- A Lean Six Sigma Green Belt project examining 37,214 eCustomerCare (eCC) cases on Where is My Package (WIMP) events is ongoing by the Delivery Strategies

and Planning group. The goal is to identify key root cause events that drive customer complaints related to package delivery and then develop strategies to implement for improvement.

- A series of #Postal Proud video's with Stand Up Talks were produced and issued to the field to reduce carrier confusion and improve the customer experience with the Postal Service. Topics of the Videos were:

1 – “Deliver Accurately” (Scanning)

2 – “Deliver with No Misdelsiveries” Location (Misdelsivery)

3 – “Say No to the Throw” (reduce damaged packages)

4 – “Keeping it Courteous” (improve carrier/customer interaction)

- The Mobile Delivery Device menu was modified to increase the visibility of scanning events other than the Undeliverable as Addressed option. Headquarters Delivery Strategy & Planning group is also working to add attributes to clarify the intended purpose of Undeliverable as Addressed as a Return to Sender event scan – as a step to the customer experience.

* * * *

As shown in the sections above, the Postal Service is taking a very proactive approach to improving customer satisfaction. It continues to analyze all available data to determine the root causes of any lack of satisfaction and uses a variety of initiatives to identify concerns and to implement solutions. These efforts have resulted in an increase in overall customer satisfaction in FY 2016 on which the Postal Service expects to build in FY 2017.

C. Consumer Access to Postal Services

Information regarding Post Offices, collection boxes, wait time in line, and delivery points is contained in USPS-FY16-33. The Postal Service did not close Postal Service operated retail facilities in FY 2016;⁴⁷ see additional discussion on suspended retail units below.

At the end of FY 2016, there were 26,611 Post Offices, 4,451 stations and branches, and 523 carrier annexes. At the end of FY 2016 there were 2,880 Contract Postal Units (CPUs), 855 Village Post Offices (VPOs), and 8,253 Approved Shipper active locations. Nationally, there were 148,267 collection boxes available at the end of FY 2016, compared to 154,006 at the beginning of FY 2016. Average wait time in line increased at the national level from 2 minutes 36 seconds in FY 2015 to 2 minutes 48 seconds in FY 2016.

In the FY 2015 ACD, the Commission noted that the number of Postal Service operated retail units under suspension has continued to grow. ACD at 150. The Commission took note of the number of suspended units, and expressed concern about this growth trend. *Id.* The Commission reiterated its recommendation that the Postal Service proceed expeditiously in determining whether to discontinue or reopen suspended retail facilities. *Id.* The Commission expected the Postal Service to reduce the number of facilities under suspension in FY 2016. *Id.* Absent a reduction in the backlog, the Commission directed the Postal Service to include a detailed explanation of why measures were not taken to address suspended retail units in the FY 2016 ACR.

⁴⁷ USPS-FY16-33 assigns numerical values for the “Closings During Fiscal Year” column; however, these numbers are the result of discontinued finance numbers and similar accounting adjustments, and do not represent the closing of any physical postal retail facilities.

The Postal Service appreciates and shares the Commission's concern with the backlog in retail facility suspensions. Of course, the Postal Service has made provision for service alternatives for customers served by the affected facilities while they continue to be in suspended status. In typical suspension actions in rural areas, customers receive retail and delivery service from rural carriers and highway contract operators. Customers may also be served by nearby units which may be situated close to customers' place of employment, as well as convenient alternatives, including usps.com, Village Post Offices (VPOs), and contractor-operated retail units. Delivery may be effected at nearby retail units, cluster box units (CBUs), or other delivery mode. In urban and suburban areas, customers may typically avail themselves of retail alternatives, such as nearby retail units, approved shippers, and the Postal Service's web offerings.

In FY 2016, the Postal Service directed all available management focus and resources in its operations towards service performance improvement, and understandably efforts to clear the backlog of suspended offices did not rise to the forefront of management's priorities. Moreover, retail discontinuance actions often elicit questions and concerns from stakeholders, both at the federal and local level, and confusion can arise whenever a large scale effort to discontinue retail units, even those that are in longstanding suspended status, are announced. Further, clearing the backlog of suspensions could have complicated efforts at the federal level to secure necessary consensus on ongoing legislative reforms under consideration. Consequently, action on clearing the backlog of suspensions was essentially deferred in FY 2016.

As of the end of FY 2016, 264 suspended facilities had undergone the retail discontinuance process to its conclusion, except for publication of the announcement of the discontinuance in the *Postal Bulletin* under Handbook PO-101 § 422.34. Another 391 retail units under suspension are at earlier stages of the review or discontinuance process. As for the 264 suspended retail units that have undergone the discontinuance process, in the near term in FY 2017, the Postal Service intends to publish final notice of discontinuances in the *Postal Bulletin*. This measure will reduce the number of pending suspensions to 391. Throughout FY 2017, local management will resume its review of the remaining suspensions under applicable regulations. If no alternate quarters can be identified, the affected facilities will be subjected to further review in the discontinuance process throughout the course of the fiscal year. Due to the volume of affected units, this process may continue beyond the close of the current fiscal year.

IV. COMPETITIVE PRODUCTS

A. Product-by-Product Costs, Revenues, and Volumes

For FY 2016, cost, revenues, and volumes for competitive products of general applicability are shown directly in the FY 2016 CRA and ICRA. In the public CRA, competitive products are disaggregated into six groups – Total Priority Mail Express, Total (non-Express) Priority Mail, Total First-Class Package Service, Total Ground, Total International Competitive, and Total Domestic Competitive Services. The constituent products for each of those groups are listed in a table in the attached Application for Non-Public Treatment of the Non-Public Annex (Attachment Two). Those groups are further disaggregated in the Nonpublic CRA (USPS-FY16-NP11). For competitive products not of general applicability, available data on international customized mailing agreements (ICMs) for FY 2016 are presented in the ICRA materials within USPS-FY16-NP2. For domestic competitive products not of general applicability, information is provided in USPS-FY16-NP27. The information currently available relating to the incremental costs of competitive products appears in USPS-FY16-NP10, although some information on competitive product groups is also reproduced in USPS-FY16-43.

B. Section 3633 Standards

The competitive product pricing standards of section 3633 have been implemented by the Commission at 39 C.F.R. § 3015.7. This section discusses the available FY 2016 data with reference to those standards.

i. Subsection 3633(a)(1)

Subsection 3633(a)(1) states that competitive products should not be cross-subsidized by market dominant products. The Commission's regulations define the most appropriate test for this standard as the incremental cost test for the aggregation of competitive products.⁴⁸ Simply stated, if the aggregate revenues from competitive products equal or exceed the aggregate incremental costs of competitive products, then competitive products overall are not being cross-subsidized by market dominant products.

As in past ACRs, the Postal Service is presenting what can be termed a "hybrid" estimate of incremental costs, in which an estimate of the aggregate incremental costs of domestic competitive products (including group specific costs) is added to an estimate of the volume variable plus product specific costs of international competitive products. The "hybrid" characterization reflects the blending of an actual estimate of domestic incremental costs with a volume variable plus product specific cost proxy for international incremental costs. The need for the hybrid approach is caused by the structure of the ICRA, which precludes direct application of the incremental cost model to international products. As demonstrated in Proposal 22, Docket No. RM2010-4, the hybrid estimate is an improvement over the full proxy of volume variable plus product specific costs for both domestic and international competitive products, plus group specific costs, used before FY 2009.⁴⁹ The hybrid approach provides stronger protection against cross-subsidy than the previous full proxy approach.

⁴⁸ See 39 C.F.R. § 3015.7(a).

⁴⁹ Proposal 22 was approved by the Commission in Order No. 399, Docket No. RM2010-4 (Jan. 27, 2010).

The incremental cost for domestic competitive products, and the hybrid incremental cost proxy for the group of all competitive products -- fully documented in USPS-FY16-NP10 -- are presented below.

FY2016 INCREMENTAL COST CALCULATION FOR TOTAL COMPETITIVE PRODUCTS¹

	Volume Variable & Product Specific Cost	Group Specific	Incremental	Hybrid Incremental
Domestic Competitive Mail (& Market Tests)	\$ 11,434,015	\$ 34,820	\$ 11,729,158	\$ 11,729,158
International Competitive	\$ 1,062,215	\$ -	na	\$ 1,062,215
Total Competitive	\$ 12,496,230	\$ 34,820	na	\$ 12,791,373

¹ Costs are (\$000).

The total competitive hybrid incremental cost is \$12,791,373 thousand, which is the sum of the hybrid incremental costs for domestic competitive mail and the hybrid incremental cost proxy for international competitive. Before acceptance of Proposal 22 in Docket No. RM2010-4, for purposes of the cross-subsidy test, the Commission used the sum of volume variable and product specific costs of competitive products, plus the group specific cost of competitive products. That full proxy, if applied in FY2016, would provide a cost floor of \$12,531,050 thousand (\$12,496,230 + \$34,820). The hybrid provides a preferred cost floor because it is derived mostly from properly calculated incremental costs, and is a better approximation of the true incremental costs required for the test.⁵⁰

The hybrid incremental costs of \$12.791 billion are well below total competitive products revenue of \$18.495 billion (shown on page 3 of USPS-FY16-1). Therefore,

⁵⁰ As demonstrated in Proposal 22, the resulting hybrid will be greater than the group's overall volume variable plus product specific costs (while not overstating the incremental costs for competitive products). This means that the hybrid is a preferred cost floor for performing a cross subsidy test.

based on these estimates, it is clear that competitive products in FY 2016 were not cross-subsidized by market dominant products, and thus were in compliance with subsection 3633(a)(1).

ii. Subsection 3633(a)(2)

Subsection 3633(a)(2) requires that each competitive product cover its costs (i.e., maintain a cost coverage of at least 100 percent). As discussed above, the CRA Reports for FY 2016 presented in USPS-FY16-1 and USPS-FY16-NP11 continue to show product-level costs as the sum of volume variable and product specific costs. To the extent that they can be produced, incremental costs (i.e., the sum of volume variable costs, product specific cost, and the inframarginal costs identified in the incremental cost models) for competitive products appear in USPS-FY16-NP10. Cost coverages (the ratio of revenue to cost) are included each place within those folders where the respective cost measure information is presented. As shown in the Nonpublic CRA (USPS-FY16-NP11), USPS-FY16-NP10, USPS-FY16-NP27, and the ICRA (USPS-FY16-NP2), every competitive product maintained a cost coverage of at least 100 percent, with the exception of a few products – the non-NSA portion of Parcel Return Service, thirteen domestic NSAs, Inbound Air Parcel Post (at non-UPU Rates), International Money Transfer Service (IMTS), Outbound International Insurance, and one bilateral agreement with a foreign postal operator.

The cost coverage for the non-NSA portion of Parcel Return Service (PRS) dropped below 100 percent in FY 2016. Changes in the PRS sub-product mix have resulted in a drop in non-NSA volume from just under 7 percent of total PRS volume in FY 2015 to about 1.3 percent in FY2016. This small fraction of PRS volume, which is

essentially the residual portion after the vastly larger NSA portion is subtracted from the total, accounts for the non-NSA portion of revenue, volume and cost. The result can be cost estimates which are volatile and unstable, due to the small slice of residual volume. The Postal Service is looking into this anomalous result for FY 2016.

As noted above, thirteen domestic NSAs (twelve Priority Mail and one Parcel Return Service contracts) did not cover their attributable costs in FY2016. Five of these have either already expired or have been terminated during FY2016. Two of them have had a price increase negotiated and are expected to show improved cost coverage as a result. The remaining six are discussed below.

Contracts being renegotiated due to significant changes (deterioration) in actual profile:

- 1) Priority Mail Contract 150 (Docket No. **CP2016-12**) is a Shipping Services Contract approved on November 3, 2015. The customer pieces traveled farther (35 percent to Zone 5-9 projected to 63 percent actual) in FY 2016. The FY2016 cost coverage (98 percent) is a bit below 100 percent due to the shift in profile.
- 2) Priority Mail Contract 183 (Docket No. **CP2016-82**) is a Shipping Services Contract approved on January 6, 2016. The customer pieces showed a shift in average weight per piece from 26 lbs. projected to 11.6 lbs actual in FY 2016. The cost coverage (99 percent) is a bit below 100 percent due to this shift (heavier pieces had better cost coverage).
- 3) Priority Mail Contract 228 (Docket No. **CP2016-228**) is a Shipping Services Contract approved on July 6, 2016. This customer's actual profile was substantially heavier (7 lbs. vs 1 lb.) and traveled farther (average Zone of 7 vs 5) than the projected profile resulting in a cost coverage (34 percent) well below 100 percent.

The Postal Service is renegotiating the above contracts, and will exercise the early termination clause if the negotiations are unsuccessful.

- 4) Priority Mail Contract 160 (Docket No. **CP2016-35**) is a Shipping Services Contract approved on December 17, 2015. The customer pieces traveled farther (average zone of 2 projected to 4 actual) in FY 2016. The FY2016 cost coverage

(99 percent) is a bit below 100 percent due to the shift in profile. Annual price escalation in December 2016 has improved cost coverage above 100 percent. The Postal Service will monitor contract performance and renegotiate pricing if necessary.

- 5) Priority Mail Contract 214 (Docket No. **CP2016-167**) is a Shipping Services Contract approved on July 8, 2016. This customer did not accelerate implementation to provide adequate volume and density. If the contract does not show improvement in Q2 FY2017, agreement will be terminated.
- 6) Parcel Return Service Contract 10 (Docket No. **CP2015-89**) is a Shipping Services Contract approved on July 8, 2015. The average customer piece was much heavier (13 lbs. vs 2.5 lbs. in FY15) and as a result cost coverage dropped to 84 percent. The Postal Services is renegotiating pricing and will terminate the contract if necessary.

The Postal Service intends to evaluate these contracts at the end of the current quarter (Q1 FY2017) and take appropriate corrective action.

The Postal Service offers the following observations on international competitive products for which revenues did not exceed costs. First, Inbound Air Parcel Post at non-UPU Rates consists of negotiated rates for inbound Air Parcel Post, tendered by several European postal operators. In the Postal Service's response to the Commission's requests for additional information regarding IMTS and EPG in the FY2014 ACD, the Postal Service advised the Commission that the Postal Service had decided to provide notice to the EPG members prior to June 30, 2015, of the Postal Service's withdrawal from the EPG agreement, effective June 30, 2016.⁵¹ The Postal Service has furnished appropriate notices to this effect to the counterparties of the agreement, and exited the agreement according to its terms on June 30, 2016.⁵² The

⁵¹ See Responses of the United States Postal Service to Commission Requests for Additional Information Regarding IMTS and EPG in the FY2014 Annual Compliance Determination, Docket No. ACR2014 (June 30, 2015), at 8.

⁵² See Second Response of the United States Postal Service to Commission Requests for Additional Information in the FY2015 Annual Compliance Determination, Docket No. ACR2015 (June 27, 2016), at 12.

only remaining agreement in this grouping is a negotiated service agreement with Royal Mail, which continues to be operative.

Second, after the FY2014 ACR concluded, the Postal Service reported to the Commission the challenges involved in determining costs for International Money Transfer Service (IMTS).⁵³ The volume of IMTS continues to be small; consequently, the Postal Service reiterates its observations in its June 30, 2015 response to the FY 2014 ACD, namely, that “[b]ecause the number of IMTS transactions is small, it is difficult to obtain enough IOCS tallies through sampling to reliably estimate attributable cost for IMTS, resulting in relatively volatile unit costs.”⁵⁴ The Postal Service has taken mitigation steps that will be in place in short order. Specifically, rates for IMTS-Outbound will rise substantially on January 22, 2017, when International Postal Money Order fees will increase by over 73 percent. The Commission has taken note of this precipitous increase and observed that “[a]ll else remaining equal, this price increase should generate sufficient revenue to cover the attributable costs for Outbound IMTS.”⁵⁵ Thus, the Postal Service has taken measures to address the cost coverage of IMTS-Outbound.

⁵³ See Responses of the United States Postal Service to Commission Requests for Additional Information Regarding IMTS and EPG in the FY2014 Annual Compliance Determination, Docket No. ACR2014 (June 30, 2015), at 2-7. See *also* Responses of the United States Postal Service to Questions 1-14 of Chairman’s Information Request No. 2, Docket No. ACR2015 (January 15, 2016), Response to Question 10; Second Response of the United States Postal Service to Commission Requests for Additional Information in the FY2015 Annual Compliance Determination, Docket No. ACR2015 (June 27, 2016), at 6-8.

⁵⁴ Responses of the United States Postal Service to Commission Requests for Additional Information Regarding IMTS and EPG in the FY2014 Annual Compliance Determination, Docket No. ACR2014 (June 30, 2015), at 4.

⁵⁵ PRC Order No. 3622, Order Approving Price Adjustments for Competitive Products, Docket No. CP2017-20 (November 18, 2016), at 8.

Third, the Postal Service notes that Outbound International Insurance did not cover costs. The Postal Service notes, however, that the difference between the costs and revenues for international insurance is small, and Priority Mail Express International insurance fees and Priority Mail International insurance fees were both raised by over 4 percent in the most recent published price change that is scheduled to go into effect on January 22, 2017. Should this product continue to fail to perform, management will propose further remedial measures for consideration.

Finally, the international bilateral agreement in Docket No. CP2015-136 did not cover costs. Although the agreement has been extended to March 31, 2017,⁵⁶ the Postal Service intends to replace that agreement with rates that provide adequate cost coverage at the product level, assuming that a successor agreement is negotiated and executed.

iii. Subsection 3633(a)(3)

Subsection 3633(a)(3) states that competitive products must collectively cover what the Commission determines to be an appropriate share of the Postal Service's institutional costs. In its regulations, the Commission has determined that an appropriate minimum share is 5.5 percent of total institutional costs.⁵⁷ Page 3 of USPS-FY16-1 shows total institutional costs of \$36.363 billion. Applying the 5.5 percent to that figure yields a target contribution of \$2.000 billion. Page 3 of USPS-FY16-1 shows total competitive product volume variable and product specific costs of \$12.496 billion, and

⁵⁶ PRC Order No. 3618, Order Approving Modification to Existing Agreement, Docket Nos. CP2015-136 and R2015-6 (November 16, 2016).

⁵⁷ See 39 C.F.R. § 3015.7(c). The Commission In 2012 affirmed 5.5 percent as an appropriate minimum share of total institutional costs to be borne by competitive products. Order No. 1449, Docket No. RM2012-3 (Aug. 23, 2012).

total competitive product revenue of \$18.495 billion. Subtracting the former from the latter results in total competitive product contribution of \$5.999 billion. Taking into account the competitive market test net contribution figure of -\$2.6 million reported in USPS-FY16-NP27, the overall net competitive contribution amount changes to \$5.997 billion, which is greater than the \$2.000 billion target by a wide margin. Thus, the subsection 3633(a)(3) requirement was met in FY 2016.

V. MARKET TESTS AND NONPOSTAL SERVICES

A. Market Dominant Market Tests

In FY2016, there were no market test of experimental products offered under the provisions of section 3641 that were categorized as market dominant.

B. Competitive Market Tests

Customized Delivery, IMRS, GEM Merchant Solution, and Metro Post were the only competitive market tests of experimental products authorized under the provisions of section 3641 in FY 2016. Information for these market tests is provided under seal in USPS-FY16-NP27. The Postal Service does not have a method for estimating the quality of service of its competitive experimental products. The Postal Service does not believe that the offering of these competitive experimental products created an inappropriate competitive advantage for the Postal Service or any mailer.

C. Nonpostal Services

On December 11, 2012, the Commission issued an order approving Mail Classification Schedule (MCS) descriptions and prices for nonpostal service products.⁵⁸ The approved MCS includes 11 nonpostal service products, two of which are market dominant and nine of which are competitive. FY 2016 revenue, cost, and volume data for the two market dominant products are provided below.

⁵⁸ Order No. 1575, Docket No. MC2010-24 (Dec. 11, 2012).

**1 Alliances with the Private Sector to Defray Costs
[includes MoverSource nonpostal service]**

Revenue	\$ 42,203,629
Expense	\$ 1,894,242
Net Income (Loss)	<u>\$ 40,309,387</u>

Volume	<u>NA</u>
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2 Philatelic Sales

Revenue*	\$ 14,438,423
Expense*	<u>\$ 9,719,465</u>
Net Income (Loss)	<u>\$ 4,718,958</u>

Volume	<u>3,409,944</u>
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*Revenue and expense are for fulfillment only

Comparable data for the seven competitive nonpostal services in effect and active in FY 2016 are provided in USPS-FY16-NP27.

VI. NONPUBLIC ANNEX

Section 3652(f)(1) contemplates the use of a nonpublic annex for documents or other materials that the Postal Service considers exempt from public disclosure, pursuant to 39 U.S.C. § 410(c) and 5 U.S.C. § 552(b). In particular, section 410(c)(2) exempts from mandatory disclosure “information of a commercial nature...which under good business practice would not be publicly disclosed.” Accordingly, such information is contained in this Report’s nonpublic annex.

A complete listing of the contents of the nonpublic annex appears at Attachment One. In general, the nonpublic annex contains the same types of materials that were included in the nonpublic annex in Docket No. ACR2015. Thus, its primary contents are:

- (1) versions of the CRA and Cost Segments and Components reports that provide disaggregated information for competitive products, and supporting materials underlying the CRA (such as the CRA “B” workpapers, the CRA model, and files relating to the various costing data systems);
- (2) the ICRA, supporting materials underlying the ICRA, and data for international customized agreements with customers;
- (3) billing determinants for domestic and international competitive products; and
- (4) information on individual domestic competitive product NSAs.

An Application for Nonpublic Treatment of Materials regarding the nonpublic annex appears at Attachment Two.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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LIST OF APPENDED MATERIALS

PUBLIC FOLDERS

USPS-FY16-1	FY 2016 Public Cost and Revenue Analysis (PCRA) Report
USPS-FY16-2	FY 2016 Public Cost Segments and Components Report
USPS-FY16-3	FY 2016 Discounts and Passthroughs of Workshare Items
USPS-FY16-4	FY 2016 Market Dominant Billing Determinants
USPS-FY16-5	Cost Segment and Components Reconciliation to Financial Statements and Account Reallocations (Reallocated Trial Balances)
USPS-FY16-6	General Classification of Accounts (Formerly Handbook F-8)
USPS-FY16-7	Cost Segment 3 Cost Pools & Other Related Information (Public Portion)
USPS-FY16-8	Equipment and Facility Related Costs
USPS-FY16-9	FY 2016 ACR Roadmap Document
USPS-FY16-10	FY 2016 Special Cost Studies Workpapers - Letter Cost Models (First and Standard)
USPS-FY16-11	FY 2016 Special Cost Studies Workpapers - Flat Cost Models (First and Standard) & Periodicals Cost Model
USPS-FY16-12	Standard Mail Parcel Mail Processing Cost Model
USPS-FY16-13	FY 2016 Standard Mail and Periodicals Destination Entry Cost Models
USPS-FY16-14	Mail Characteristics Study (Public Portion)
USPS-FY16-15	Bound Printed Matter Mail Processing Cost Model and Media Mail – Library Mail Mail Processing Cost Model
USPS-FY16-16	Bound Printed Matter Transportation Cost Model and Bulk Parcel Return Service Cost Model

Attachment One

USPS-FY16-17	2016 Annual Report and Comprehensive Statement of Postal Operations
USPS-FY16-18	FY 2016 ECR Mail Processing Unit Costs
USPS-FY16-19	FY 2016 Delivery Costs By Shape
USPS-FY16-20	FY 2016 Window Service Cost by Shape
USPS-FY16-21	Business Reply Mail Cost Model
USPS-FY16-22	FY 2016 Bound Printed Matter Mail Processing Costs
USPS-FY16-23	MODS Productivity Data
USPS-FY16-24	FY 2016 Non-Operation Specific Piggyback Factors (Public Portion)
USPS-FY16-25	FY 2016 Mail Processing Piggyback Factors (Operation Specific)
USPS-FY16-26	FY 2016 Mail Processing Costs by Shape (Public Portion)
USPS-FY16-27	FY 2016 Nonprofit Mail Cost Approximations
USPS-FY16-28	FY 2016 Special Cost Studies Workpapers – Special Services (Public Portion)
USPS-FY16-29	Annual Report on Service Performance for Market Dominant Products
USPS-FY16-30	FY 2016 Market Dominant NSA Materials
USPS-FY16-31	FY 2016 CRA Model (Model Files, Cost Matrices, and Reports) (Public Version)
USPS-FY16-32	FY 2016 CRA “B” Workpapers (Public Version)
USPS-FY16-33	Consumer Access to Postal Services
USPS-FY16-34	City Carrier Cost System (CCCS) Documentation (Public Version)
USPS-FY16-35	Rural Carrier Cost System (RCCS) Documentation (Public Version)

USPS-FY16-36	Transportation Cost Systems (TRACS) Documentation (Public Version)
USPS-FY16-37	In-Office Cost System (IOCS) Documentation (Public Version)
USPS-FY16-38	USPS Market Dominant Product Customer Satisfaction Measurement Survey Instruments
USPS-FY16-39	FY 2016 Competitive Products Fund Reporting Materials
USPS-FY16-40	2016 Rural Mail Count
USPS-FY16-41	International Market Dominant Billing Determinants
USPS-FY16-42	FY 2016 Revenue, Pieces, and Weight Report (Public Version)
USPS-FY16-43	FY 2016 Market Dominant Products Incremental Costs
USPS-FY16-44	Update to Periodicals Pricing Report

NONPUBLIC FOLDERS:

USPS-FY16-NP1	FY 2016 Domestic Competitive Product Billing Determinants
USPS-FY16-NP2	FY 2016 International Cost and Revenue Analysis (ICRA) Report (Hard Copy & Excel)
USPS-FY16-NP3	FY 2016 International Cost Segments and Components Report (Hard Copy & Excel)
USPS-FY16-NP4	FY 2016 ICRA Domestic Processing Model (Cost Matrices, Reports, Control File, & Changes)
USPS-FY16-NP5	FY 2016 ICRA Overview/Technical Description
USPS-FY16-NP6	FY 2016 International Cost Segment Spreadsheets
USPS-FY16-NP7	Cost Segment 3 International Product Costs by Cost Pools (Volume Variable Cost Pools)

USPS-FY16-NP8	FY 2016 International Billing Determinants
USPS-FY16-NP9	FY 2016 Miscellaneous International Data
USPS-FY16-NP10	FY 2016 Competitive Product Incremental and Group Specific Costs
USPS-FY16-NP11	FY 2016 Nonpublic Cost and Revenue Analysis (NPCRA) Report (Hard copy & Excel)
USPS-FY16-NP12	FY 2016 Nonpublic Cost Segments and Components Report (Hard copy & Excel)
USPS-FY16-NP13	FY 2016 CRA Model (Model Files, Cost Matrices, and Reports)
USPS-FY16-NP14	FY 2016 CRA "B" Workpapers (Nonpublic Version)
USPS-FY16-NP15	Parcel Select / Parcel Return Service (PRS) Mail Processing Cost Model
USPS-FY16-NP16	Parcel Select / Parcel Return Service (PRS) Transportation Cost Model
USPS-FY16-NP17	Parcel Select / Parcel Return Service (PRS) Cube-Weight Relationship Estimation
USPS-FY16-NP18	Cost Segment 3 Cost Pools & Other Related Information (Nonpublic Portion)
USPS-FY16-NP19	FY 2016 Non-Operation Specific Piggyback Factors (Nonpublic Portion)
USPS-FY16-NP20	FY 2016 Mail Processing Costs by Shape (Nonpublic Portion)
USPS-FY16-NP21	In-Office Cost System (IOCS) Documentation (Nonpublic Version)
USPS-FY16-NP22	City Carrier Cost System (CCCS) Documentation (Nonpublic Version)
USPS-FY16-NP23	Rural Carrier Cost System (RCCS) Documentation (Nonpublic Version)

Attachment One

USPS-FY16-NP24	Transportation Cost Systems (TRACS) Documentation (Nonpublic Version)
USPS-FY16-NP25	Mail Characteristics Study (Nonpublic Portion)
USPS-FY16-NP26	FY 2016 Special Cost Studies Workpapers – Special Services (Nonpublic Portion)
USPS-FY16-NP27	FY 2016 Domestic Competitive NSA & Nonpostals Materials
USPS-FY16-NP28	FY 2016 Revenue, Pieces, and Weight Report (Nonpublic Version)
USPS-FY16-NP29	Cost Segment and Components Reconciliation to Financial Statements and Account Reallocations (Reallocated Trial Balances) (Nonpublic Version)

**APPLICATION OF THE UNITED STATES POSTAL SERVICE
FOR NONPUBLIC TREATMENT OF MATERIALS**

In accordance with 39 C.F.R. § 3007.21 and Order No. 225,¹ the United States Postal Service (Postal Service) hereby applies for nonpublic treatment of the twenty-nine appended folders identified as nonpublic in Attachment One of the FY 2016 Annual Compliance Report (collectively, the “Nonpublic Annex”). As is apparent from the Attachment One list, the majority of the folders in the Nonpublic Annex have a corresponding public folder.

In many instances, a set of material has been divided into one portion that relates to Market Dominant products and another portion that relates to Competitive products. In those instances, the public folder includes the portion of material relating to Market Dominant products, and the nonpublic folder includes the portion of materials relating to Competitive products. In many other instances, two versions of materials are prepared, one that is public and contains aggregated information regarding Competitive products or large groups of Competitive products, and another that is nonpublic and contains information regarding Competitive products that is disaggregated to the product level. In general, except for the six groups of Competitive products for which cost data are shown in the Cost and Revenue Analysis (CRA), all disaggregated cost information relating to Competitive products, and all background data used to develop disaggregated cost information on Competitive products, are filed under seal in the Nonpublic Annex.

¹ Order No. 225, Final Rules Establishing Appropriate Confidentiality Procedures, Docket No. RM2008-1 (June 19, 2009).

(1) The rationale for claiming that the materials are nonpublic, including the specific statutory basis for the claim, and a statement justifying application of the provision(s);

The materials designated as nonpublic consist of commercial information concerning postal operations and finances that under good business practice would not be disclosed publicly. Based on its longstanding and deep familiarity with the postal and communications businesses and markets generally, and its knowledge of many firms, including competitors, mailers, and suppliers, the Postal Service does not believe that any commercial enterprise would voluntarily publish information pertaining to the costs, volumes, revenues, and markets for its competitive products, as well as inbound market dominant products for which rates are negotiated with other postal operators. In the Postal Service's view, this information would be exempt from mandatory disclosure pursuant to 39 U.S.C. § 410(c)(2) and 5 U.S.C. § 552(b)(3) and (4).²

(2) Identification, including name, phone number, and email address for any third-party who is known to have a proprietary interest in the materials, or if such an identification is sensitive, contact information for a Postal Service employee who shall provide notice to that third party;

The Postal Service believes that the only third parties that have a proprietary interest in the materials submitted in connection with the FY 2016 Annual Compliance Report are identified in Appendix 1 to this Application. The Postal Service also hereby provides notice that it has already informed each third party, in compliance with 39 C.F.R. § 3007.20(b), of the nature and scope of this filing and its right to address its

² In appropriate circumstances, the Commission may determine the appropriate level of confidentiality to be afforded to such information after weighing the nature and extent of the likely commercial injury to the Postal Service against the public interest in maintaining the financial transparency of a government establishment competing in commercial markets. 39 U.S.C. § 504(g)(3)(A). The Commission has indicated that "likely commercial injury" should be construed broadly to encompass other types of injury, such as harms to privacy, deliberative process, or law enforcement interests. Order No. 194, Second Notice of Proposed Rulemaking to Establish a Procedure for According Appropriate Confidentiality, Docket No. RM2008-1 (Mar. 20, 2009), at 11.

confidentiality concerns directly with the Commission.³ In addition, because the Postal Service maintains that (i) some competitive negotiated service agreement (NSA) customers' identities are commercially sensitive and should not be publicly disclosed, and (ii) language and cultural barriers may make it difficult for those seeking access to nonpublic information to provide proper notice to the applicable third parties, Postal Service employees who will be responsible for providing notice to these specific third parties are also identified in Appendix 1.

The Postal Service further provides, as identified in Appendix 2 to this Application, a list of those third parties that have a proprietary interest in the materials by nonpublic folder.

(3) A description of the materials claimed to be nonpublic in a manner that, without revealing the materials at issue, would allow a person to thoroughly evaluate the basis for the claim that they are nonpublic;

The materials in the Nonpublic Annex fall into several categories. The first category is the Nonpublic CRA, and all of the background materials feeding into the Nonpublic CRA. These materials, in general, show cost information at the product level, including disaggregated information for Competitive products. These materials are found in folders USPS-FY16-NP10, USPS-FY16-NP11 - USPS-FY16-NP14, USPS-FY16-NP18 - USPS-FY16-NP25, and USPS-FY16-NP27. Descriptions of the contents of these folders can be found in the roadmap document, filed at USPS-FY16-9. The roadmap indicates the corresponding public folder which contains information similar to

³ The Postal Service, in conjunction with the United States State Department, has requested that the Universal Postal Union International Bureau (IB) issue a Circular notice to all countries and designated operators informing each of its rights under 39 C.F.R. § 3007.20(c). This notification should be published shortly by the IB.

that in each nonpublic folder, except that, in the public folder, the cost information for Competitive products is generally aggregated into one Competitive products row. Therefore, examination of the corresponding public folder should allow a person to understand the nature of the contents of the nonpublic folder, and evaluate accordingly.

A second category consists of Special Cost Studies materials that provide cost information below the product level for Competitive products. These materials are found in folders USPS-FY16-NP15 - USPS-FY16-NP17, and USPS-FY16-NP26. Again, descriptions of the contents of these folders can be found in the roadmap document, filed at USPS-FY16-9. The roadmap indicates the corresponding public folder which contains information similar to that in the nonpublic folder, except that, in the public folder, the cost information below the product level relates to Market Dominant, rather than Competitive, products. Therefore, examination of the corresponding public folder should allow a person to understand the nature of the contents of the nonpublic folder, and evaluate accordingly.

A third category consists of the International CRA (ICRA) and the supporting documentation. These materials are found in folders USPS-FY16-NP2 - USPS-FY16-NP7 and USPS-FY16-NP9. Collectively, they present the inputs and the analyses used to attribute and distribute costs to International products. In general, the ICRA follows the same basic methodologies used in the CRA – dividing accounting data into cost segments and components, distributing the attributable costs within segments to products, and summing the total attributable costs of a product across segments. Descriptions of the contents of the individual ICRA-related folders can be found in the roadmap document, USPS-FY16-9. There are no corresponding public folders.

A fourth category is the Competitive product billing determinants. These are found in USPS-FY16-NP1 for domestic Competitive products, and USPS-FY16-NP8 for International products. They are comparable in format to the Market Dominant billing determinants presented in USPS-FY16-4, but include the corresponding information for Competitive products. Again, examination of the corresponding public folder should allow a person to understand the nature of the contents of the nonpublic folder, and evaluate accordingly.

In general, the premise of this application is that, for Competitive products and certain market dominant International products, disaggregated cost data (and detailed volume and revenue data, such as that provided in billing determinants) constitute commercially-sensitive information and should not be publicly disclosed. The Postal Service is therefore placing all such information in the Nonpublic Annex, and filing it under seal. One exception to this approach appears in the CRA. The CRA (USPS-FY16-1) presents some disaggregated data for Competitive products, but those data are not disaggregated down to the product level, as they are in the Nonpublic CRA (USPS-FY16-NP11). Instead, in the CRA, the Postal Service has aggregated data for Competitive products into six product groups. Those groups are Total Priority Mail Express, Total First-Class Package Service, Total (non-Express) Priority, Total Ground, Total Competitive International, and Total Domestic Competitive Services. (The product rows in the Nonpublic CRA that are rolled up into each of the six Competitive product group rows in the CRA are shown in the table below.) At this level of disaggregation, the Postal Service has been unable to identify any of its major competitors that are publicly disclosing a potentially greater amount of disaggregated competitive cost data.

The Postal Service maintains that the further disaggregation shown in the Nonpublic CRA should thus appropriately remain confidential. The Postal Service believes that the approach jointly embodied in its CRA and Nonpublic CRA prudently maximizes the amount of information available to the public, keeping such information as detailed as possible without prompting the competitive concerns outlined in the following section.

FY2016 Public-Nonpublic Crosswalk Table

Category in Public Version CRA	Categories Rolled in from Nonpublic Version CRA
Total Priority Mail Express	Domestic Priority Mail Express Domestic Priority Mail Express NSAs
Total First-Class Package Service	First-Class Package Service First-Class Package Service NSAs
Total Priority Mail	Domestic Priority Mail Domestic Priority Mail NSAs Priority Mail Fees
Total Ground	Parcel Select Mail Parcel Select NSAs Parcel Return Service Mail Parcel Return Service NSAs Standard Post
Total Competitive International	Outbound International Expedited Services Inbound EMS Outbound Priority Mail International Inbound Parcel Post (at UPU Rates) First-Class Package International Service International Priority Airmail (IPA) International Surface Airlift (ISAL) International Direct Sacks M-Bags Outbound International NSA Mail Inbound International NSA Mail International Mail Fees International Money Transfer Service International Ancillary Services
Total Domestic Competitive Services	Premium Forwarding Service Address Enhancement Services Greeting Cards Shipping and Mailing Supplies Post Office Box Service Other Ancillary Services

(4) Particular identification of the nature and extent of commercial harm alleged and the likelihood of such harm;

If the information the Postal Service determined to be protected from disclosure due to its commercially sensitive nature were to be disclosed publicly, the Postal Service considers it quite likely that it would suffer commercial harm. This information is commercially sensitive, and the Postal Service does not believe that it would be disclosed under good business practices. In this regard, the Postal Service is not aware of any business with which it competes (or in any other commercial enterprise), either within industries engaged in the carriage and delivery of materials and hard copy messages, or those engaged in communications generally, that would disclose publicly information and data of comparable nature and detail.

The protected materials consist of comprehensive analytical tools and reports employed by the Postal Service for several purposes in its operations and finances. Most prominently, in the context of the ACR, they enable the Postal Service to address the issues mandated in 39 U.S.C. § 3652(a) having to do with the costs, revenues, rates, and quality of service of competitive postal products. Furthermore, many of the materials outlined in section (3) above consist of sub-reports, workpapers, and other documentation used to create the basic reports in the CRA and ICRA. These materials share the protected status and confidential nature of the basic reports, since they provide the building blocks that permit compilation of the data and statistics and would permit competitors to gain the same types of knowledge, understanding, and insights at

finer levels of detail. The Postal Service believes that this information would lead to competitive harm, if publicly disclosed.

As explained below, the data and information considered to be nonpublic can be classified in several general groupings: product cost information; general product volume and revenue information; product billing determinants; and information pertaining to service and pricing agreements with particular mailers or suppliers (NSAs). The following describes generally the expected harms from each of these classes of information. The explanations also include a separate discussion of international mail products, and their relatively distinct characteristics that arise from the structure of international business, including the involvement of foreign postal operators and international organizations.

Cost Information

Information relating to the costs of producing products is generally considered to be among the most sensitive commercial information. The CRA and ICRA present data and statistics for products that would provide competitors with valuable information, enabling them to better understand the Postal Service's cost structures, operational capabilities, and pricing and marketing strategies. This confidential information includes per-piece costs in several analytical categories (attributable costs, volume variable costs, and product-specific costs), as well as cost contribution and cost coverage (margin) by product. Such information would be extremely valuable to competitors in assessing the strengths and weaknesses of various postal products. Armed with detailed product cost information, competitors would be able to better identify and

understand areas where they could adapt their own operations to be more competitive with postal products and better assess how to price and market their own products in such a way as to target the Postal Service's weaknesses and compensate for its strengths in producing and marketing various products. Furthermore, information contained in the various sub-reports, workpapers, and other documentation that feed the reports would provide an even more refined knowledge of the Postal Service's costs, cost structures, and capabilities. In this regard, the structure of the Postal Service's analytical tools and reports is well known among the postal community from years of exposure in general rate cases under the former regulatory regime. Postal costs are recorded in elaborate systems of general ledger accounts. These are grouped into various functional and other categories (cost segments and components) for further analysis and ultimate allocation and distribution to individual products. The level of detail contained in the sub-reports and workpapers is highly refined and would enable competitors, and existing and potential customers with whom the Postal Service might negotiate particular contract rates, to gain competitive or negotiating advantages that could lead to suppressing potential financial gains from the sale of postal products or the diversion of business away from the Postal Service to competitors. Either of these results would constitute serious commercial harm.

Volume and Revenue Information

Competitors could use the product-specific revenue, pieces, and weight information to analyze the Postal Service's possible market strengths and weaknesses and to focus sales and marketing efforts on those areas, to the detriment of the Postal

Service. Disclosure of this information would also undermine the Postal Service's position in negotiating favorable terms with potential customers, who would be able to ascertain critical information about relevant product trends (e.g., average revenue per piece, average weight per piece). Finally, as explained in greater detail below, disclosure would expose certain foreign postal operators and other customers to the same competitive harms, to the extent that a category is associated with a single customer or a small group of customers. The Postal Service considers these to be highly probable outcomes that would result from public disclosure of the material filed nonpublicly.

Billing Determinants

Billing determinants present a special category of volume and revenue information that would enable highly refined understanding of individual products aligned specifically to their individual price structures. In this regard, billing determinants present a picture of each product's experience, analyzed according to the different mail characteristics that comprise the elements of the product's price structure. Detailed billing determinants, especially combined with specific product cost information, would enable competitors to better analyze the strengths and weaknesses of individual products, including specific elements of the markets for them, such as advantages in certain weight categories and distance zones. This information would provide insights into how competitors might adapt their operations and product offerings, alter their pricing, and target their marketing to take business away from the Postal Service.

Armed with this type of information, competitors would likely focus their marketing and price cutting efforts on the Postal Service's most profitable products. This would lead to erosion of contribution for these products through lost sales and/or the need to lower prices to remain competitive. Postal product cost and contribution information would provide suppliers of postal transportation and other services with information they could use to seek higher rates for services they provide. This would lead to higher postal costs and loss of contribution. Although the extent of the commercial harm is difficult to quantify, even small changes in market share, prices, or costs could lead to millions of dollars in lost revenue, higher costs, and lower margins. It is highly likely that if this information were made public, the Postal Service's competitors and suppliers would take advantage of it almost immediately.

Negotiated Service Agreements

The utility of the sensitive information in billing determinants and other materials would be particularly enhanced with regard to NSA product information relating to particular customers. First, revealing any customer identifying information would enable competitors to focus marketing efforts on current postal customers that have been cultivated through the Postal Service's efforts and resources. The Postal Service considers it highly probable that, if this information were made public, the Postal Service's competitors would take immediate advantage of it. Many NSAs include a provision allowing the mailer to terminate the contract without cause by providing at least 30 calendar days' notice. Therefore, there is a substantial likelihood of losing the customers to a competitor that targets them with lower pricing.

Other NSA-related information consists of mailing profiles. This information, if disclosed from any source within the CRA or ICRA, would offer competitors invaluable insight into the types of customers to whom the Postal Service is offering each type of competitive NSA. Even without identifying individual mailers, competitors would be able to direct their sales and marketing efforts at the customer segment that the Postal Service has had the most success at attracting. This would undermine both existing customer relationships and the potential for other new NSA customers.

A similar rationale applies to information showing product revenue, volume according to weight, pricing, and insured value levels, as well as adjustment factor calculations based on product revenues. This information is commercially sensitive, and the Postal Service does not believe that it would be disclosed under good business practices. Competitors could use the information to analyze the Postal Service's possible market strengths and weaknesses and to focus sales and marketing efforts on those areas, to the detriment of the Postal Service. The Postal Service considers these to be highly probable outcomes that would result from public disclosure of the material filed nonpublicly.

Commercially sensitive information related to NSAs is included in the agreements and their annexes, and in related financial work papers. Typically, these materials are filed under seal or redacted when the agreements are established as products. Since the Commission's rules governing confidentiality have taken effect, the Postal Service has filed applications for nonpublic status with each agreement. The reasoning expressed in those applications supports and is consistent with the discussion here.

Information derived from these documents is included in some of the materials filed in the Nonpublic Annex here. This information may include prices, product cost, contribution, or cost coverage. It also may concern customer mailing profiles, product volume, weight and revenue distribution, and product insured-value distribution.

Competitors for the services covered by these agreements consist of domestic and international transportation and delivery firms and even foreign postal operators, which could use the information to their advantage in negotiating the terms of their own agreements with the Postal Service. Competitors could also use the information to assess offers made by the Postal Service to customers for any possible comparative vulnerabilities and to focus sales and marketing efforts on those areas, to the detriment of the Postal Service. Customers could use the information to their advantage in negotiating the terms of their own agreements with the Postal Service. The Postal Service considers these to be highly probable outcomes that would result from public disclosure of the redacted material.

Potential customers, including foreign postal operators, could deduce from the rates provided in individual pricing agreements, in work papers, or in a Governors' Decision, whether additional margin for net profit exists. From this information, each customer or foreign postal operator could attempt to negotiate ever-decreasing prices or incentives, such that the Postal Service's ability to negotiate competitive yet financially sound rates would be compromised.

Information derived from financial work papers supporting NSAs can include costs, assumptions used in pricing formulas and decisions, formulas and negotiated prices, mailer profile information, projections of variables, and cost coverage and

contingency rates that have been included to account for market fluctuations and exchange risks. All of this information is highly confidential in the business world. If this information were made public, the Postal Service's competitors would have the advantage of being able to assess the Postal Service's costs and pricing and determine the absolute floor for Postal Service pricing, in light of statutory, regulatory, or policy constraints. Competitors would be able to take advantage of the information to offer lower pricing to postal customers, while subsidizing any losses with profits from other customers. Such competitors could include foreign posts, which in some instances are not required to use the Postal Service for delivery of parcels destined to the United States. Additionally, foreign postal operators or other potential customers could use costing information to their advantage in negotiating the terms of their own agreements with the Postal Service. Eventually, this could freeze the Postal Service out of the relevant markets.

International Product Information

The Postal Service believes that the same vulnerabilities and harms discussed above that would result from the disclosure of the cost, volume, and billing determinant information would also generally apply to international product information designated as nonpublic. In particular, the harms resulting from disclosure of competitive information in the CRA would also result from disclosure of similar information, workpapers, and supporting documentation related to the ICRA. International mail products and business, however, exhibit operational and pricing distinctions not always shared by domestic counterparts. In particular, international products may be either

inbound or outbound and, in some instances, are affected by bilateral and multilateral agreements among foreign postal operators. In some cases, particular lines within the ICRA reflect agreements with a single foreign postal operator. The public disclosure of this information would likely lead to limitations on the negotiating positions of both the Postal Service and the other foreign postal operator in similar agreements they might wish to negotiate with other foreign postal operators. The same is true where the partner is a private entity rather than a foreign postal operator: for example, disclosure of statistical, billing, and cost information about GXG could limit the ability of FedEx Express, a supplier to the Postal Service, to negotiate effectively, and could allow competitors to analyze the traffic for competitive advantage against FedEx Express. Further, the outbound letter monopoly has been largely suspended by virtue of 39 C.F.R. § 320.8, thereby contributing to the intensity of competition in this market. The more disaggregated nature of the product information in the international context and the relatively smaller numbers associated with them make the international data particularly vulnerable to analysis and use by competitors.

(5) At least one specific hypothetical, illustrative example of each alleged harm;

The following restates the harms discussed above and presents at least one hypothetical situation illustrating the consequences of disclosure.

Harm: Competitors, mailers, and suppliers could use cost, revenue, and volume summary data and statistics in the CRA and the ICRA, disaggregated by individual product and by NSA category, to gain knowledge and insights about the relative strengths and weaknesses of the Postal Service's competitive product lines. That refined understanding would, in turn, give competitors advantages in seeking to divert business from the Postal Service and to gain new business for which the Postal Service might compete. Mailers and suppliers would be able to negotiate favorable deals with the Postal Service more effectively. As a result, the Postal Service would experience losses of existing and new business, or erosion of contributions and margins.

Hypothetical: The CRA and ICRA provide data by product that indicate total revenues, attributable costs, volume variable costs, product specific costs, and per-piece attributable costs, contribution, and cost coverage (margin). These data are broken out by individual product and separated between products purchased through public schedules and those purchased through contract rates (NSAs). Hypothetically, this information is made public. Competitors use it to gain a refined understanding of the relative strengths and weaknesses of the Postal Service's product lines (domestic and international), the individual strengths and weaknesses of particular products, and the degree to which products are sold through public schedules, compared to contract pricing arrangements. Financial analysts for the competitors relay their assessments to colleagues in the competitors' marketing and investment divisions. This information provides a better foundation to enable competing firms to make decisions regarding investments and product design in their own product lines. Based on such assessments, for example, firms that have individual products for domestic express service (overnight), international express service, or package service comparable to Priority Mail determine that they have potential for competitive gain against the Postal Service in these areas and, accordingly, decide to allocate investments in improved operations, supplier arrangements, and technologies to improve their competitive positions. To the extent that these decisions actually make the firms more competitive, the Postal Service loses existing or new business.

Hypothetical: Cost, contribution, and/or cost coverage information is released to the public and becomes available to a competitor. The competitor, which could be a foreign postal operator operating in the United States, assesses the profitability of certain

services based on the data released. The competitor then targets its advertising and sales efforts at actual or potential customers in market segments where the Postal Service has substantial contribution, thereby hindering the Postal Service's ability to keep these customers' business.

Hypothetical: Cost, contribution, and/or cost coverage information is released to the public and becomes available to a supplier of materials, transportation, or other services. Suppliers are made aware of expected contribution margins by product and are better able to assess the relative strengths and weaknesses of the Postal Service's product lines. With this information, suppliers, including foreign postal operators in the case of international products, decide to increase the rates they charge the Postal Service to provide transportation and/or other services or become more resistant to negotiating favorable prices for their goods and services.

Hypothetical: Cost information is disclosed to the public. Mailers who seek to negotiate individual contract rates with the Postal Service gain a better understanding of the average or unit costs of particular products, as well as the relative and absolute strengths and weaknesses of particular product lines. This information enables the mailers to negotiate contract rates with the Postal Service more effectively than in the absence of such information. Similar disclosures result in advantages for foreign postal operators or other competitive entities in international mail.

Harm: The various companion reports, sub-reports, workpapers, special cost and other studies, and documentation contained in the Nonpublic Annex would provide detailed and refined knowledge and understanding of the individual costs, cost structures, contributions, and cost coverages (margins) of individual postal products and contract pricing agreements. These materials, which produce and support the summary data and statistics contained in the CRA and ICRA, would provide highly detailed information regarding operational procedures used to produce the products, the costs and relative efficiencies of

operations and sub-operations, and the amount and character of overhead, including the relative proportions of volume variable and overhead costs. Companion reports and sub-reports provide detailed functional analyses of Postal Service costs within a framework that is well-understood, or easily learned, from information in the Public Annex, or from familiarity with or research into past postal rate cases. Public disclosure would therefore be tantamount to publishing virtually every detail regarding the relative costs and efficiencies of providing postal competitive products. This information would provide blueprints for competitors, suppliers, and mailers who might seek to negotiate favorable contract rates. The information would better enable them to make favorable operational, investment, pricing, and marketing decisions in relationships with the Postal Service. The results would be loss of existing or future business for the Postal Service, or the erosion of total revenues, contributions, margins, and overall financial stability.

Hypothetical: The Cost Segments and Components reports of the CRA and ICRA are disclosed to the public. These reports group costs recorded in postal accounts according to various functional categories. The costs are distributed by postal product. The hypothetical disclosure provides competitors with a detailed understanding of the cost structures of each competitive postal product, the relative strengths and weaknesses of each product from cost perspectives, and the flexibilities available to the Postal Service within the legal framework applicable to postal prices. The refined understanding resulting from disclosure enables competitors to make decisions that would compensate for Postal Service strengths and capitalize on its weaknesses. These decisions might involve design of competing firms' own products, alternative price structures, operational procedures, and marketing strategies. They could also involve formulation of negotiating approaches and strategies by existing and potential suppliers of goods and services used in producing postal products, and the formulation of more informed negotiating positions by mailers seeking to enter into favorable contract rate arrangements with the Postal Service. Such competitive advantages lead

to diversion of business away from the Postal Service or reduction of potential contribution from individual contracts.

Hypothetical: Cost distribution models, cost estimation models, and several sub-reports feeding into the CRA and ICRA are disclosed to the public. These materials provide highly refined information that would improve understanding of product cost structures and the behavior of postal costs. Certain cost reports, such as those outlining in detail the application of specific cost pools by mail processing operation in estimating product costs, provide detailed knowledge of operational procedures employed by the Postal Service in offering products and services. This information enhances competitors' abilities to make informed decisions about investment in capital and technologies used to produce their own competing products. For example, knowledge of inflexibilities in processing Priority Mail, or in transportation used to convey Parcel Return Service, leads competitors to explore more efficient processing of competing products or to negotiate more competitive transportation contracts used for competing products. Over time, annual disclosures of such information enable competitors (or suppliers and mailers) to identify and understand trends in cost behavior that better inform their decision-making. Such developments lead to an erosion of the Postal Service's competitive position and a loss of business or contribution.

Hypothetical: Information in certain reports and documentation of special cost and other studies (e.g., Parcel Return Service cost models) is disclosed publicly. Such information provides a better understanding of the Postal Service's customer base for particular products. For instance, data from mail characteristics studies enables competitors to formulate a profile of the Postal Service's customer base for certain

products. This information better enables competitors to devise marketing and sales strategies that target the most vulnerable markets for particular postal products. More effective marketing by competitors leads to reduced sales by the Postal Service and an erosion of contributions and margins.

Hypothetical: Cost models and sub-reports feeding the CRA and ICRA reports are disclosed to the public. Detailed knowledge of the Postal Service's cost estimation, cost distribution, and special study models and procedures provides competitors, as well as mailers who seek favorable contract rates, with tools that enhance their abilities to analyze postal costs and operations. Large, sophisticated firms who have competed with the Postal Service for long periods of time have been exposed to them before and likely have developed their own sophisticated analytical tools and therefore might not benefit as much from these models; however, the hypothetical availability of this information decreases barriers to entry in certain competitive markets and creates new competitors that erode the Postal Service's customer base.

Harm: Competitors could use disaggregated product volume, weight, and revenue distribution information to assess vulnerabilities and focus sales and marketing efforts to the Postal Service's detriment.

Hypothetical: Disaggregated revenue, volume, and weights contained in the Nonpublic Annex are disclosed to the public. Another delivery service's employee monitors the filing of this information and passes it along to the firm's sales and marketing functions. The competitor assesses the profitability of certain services on a per-piece or per-pound basis or the Postal Service's relative concentration in certain service offerings. The competitor then targets its advertising and sales efforts at actual or potential customers in market segments where the Postal Service appears to have

made headway, hindering the Postal Service's ability to reach out effectively to these customers.

This example applies even more strongly for information split between NSA mail and other mail in the same category, because the competitor can assess the profitability and market strengths of the Postal Service's offerings to a small subset of NSA customers, thereby gaining somewhat more particularized insight into the characteristics of customers that the Postal Service specifically targets with its own contractual sales efforts.

Harm: Customers, including foreign postal operators, and suppliers could use disaggregated product volume, weight, and revenue distribution information to undermine the Postal Service's leverage in negotiations.

Hypothetical: Disaggregated revenue, volume, and weight information in the Nonpublic Annex is released to the public. A foreign postal operator's employee monitors the filing of this information and passes the information along to its international postal relations functions. The foreign postal operator assesses the Postal Service's average per-item or per-pound revenue for categories about which it is negotiating with the Postal Service, with particular focus on categories known to be included in bilaterals with other foreign postal operators (e.g., letter post, air and surface parcels, and EMS). Accurately or not, the foreign postal operator uses the average revenue information as a justification for pricing demands in negotiations, refusing to accept a higher price without steeper concessions than the Postal Service might otherwise have been able to foreclose. The Postal Service's ability to negotiate the best value from the bargain suffers as a result. This hypothetical applies with equal force for customers other than foreign postal operators, for NSA mail and non-NSA mail that can

be made subject to an NSA (e.g., International Priority Airmail, which can be included in Global Plus 1 NSAs), and for partnerships with suppliers such as FedEx Express with respect to GXG.

Harm: Public disclosure of information in the report would be used by competitors of the NSA customers to their detriment.

Hypothetical: A competitor of a Postal Service NSA customer obtains unredacted versions of the billing determinants for domestic and international products, including NSAs and ICMs. It analyzes the work papers to assess the customer's underlying costs and uses that information to identify lower cost alternatives to compete against the Postal Service customer. Likewise, suppliers of goods and services to the NSA customer can use the detailed information to their advantage in negotiations with the NSA customer.

Harm: Public disclosure of information contained in the Nonpublic Annex associated with international delivery services provided in partnership with specific third parties would be used by those parties' competitors to their detriment.

Hypothetical: A competitor of Canada Post Corporation, such as a competing international delivery service, obtains information contained in the Nonpublic Annex. The competitor analyzes the information to assess the average per-piece and per-pound revenue for Inbound International Letter-Post NSA Mail, Expedited Parcels and EMS which correspond to Canada Post's average per-piece and per-pound cost for U.S. delivery of its pertinent products. The competitor uses that information to assess the market potential and, as a baseline, to negotiate with U.S. customs brokers and freight companies to develop lower-cost alternatives and undermine Canada Post's market offerings. The same scenario could apply with respect to comparable

information, such as settlement charges due or payable, for other foreign postal operators or for FedEx Express concerning Global Express Guaranteed (GXG).

Harm: Competitors could use customer mailing profiles, product volume, weight, and revenue distributions, and product insured-value distribution information to assess vulnerabilities and focus sales and marketing efforts to the Postal Service's detriment.

Hypothetical: Customer mailing profile information in the Nonpublic Annex is released to the public. Another delivery service's employee monitors the filing of this information and passes the information along to its sales and marketing functions. The competitor assesses the typical size, mailing volume, and content characteristics of Postal Service NSA customers. The competitor then targets its advertising and sales efforts at actual or potential customers with similar profiles, hindering the Postal Service's ability to reach out effectively to these customers.

This hypothetical would apply even for more generic product-level data, from which one could calculate the distribution of the Postal Service's overall customer base in terms of item weight, revenue, or value (in the case of international insurance). For these reasons, release of any of the nonpublic information would pose actual commercial harm to the Postal Service, regardless of the information's present favorability.

Harm: Revealing customer identifying information associated with competitive domestic and international NSAs would enable competitors to target the customers for sales and marketing purposes.

Hypothetical: The identities of customers with which prices are established in NSAs are revealed to the public. Another expedited delivery service passes along the information to its sales function. The competitor's sales representatives quickly contact the Postal Service's customers and offer them lower rates or other incentives to

terminate their contracts with the Postal Service in favor of using the competitor's services. Lost sales undermine the Postal Service's revenues.

Harm: In billing determinants and supporting documentation pertaining to domestic and international competitive NSAs, disclosure of information that would reveal prices associated with particular pricing agreements would provide competing domestic and foreign postal operators, or other potential customers, extraordinary negotiating power to extract lower rates from the Postal Service.

Hypothetical: Customer A's negotiated rates are disclosed publicly. Customer B sees the rates and determines that there may be some additional profit margin between the rates provided to Customer A and the statutory cost coverage that the Postal Service must produce in order for the agreement to be added to the competitive products list. Customer B, which was offered rates identical to those published in Customer A's agreement, then uses the publicly available rate information to insist that it must receive lower rates than those the Postal Service has offered it, or it will not use the Postal Service for its expedited package service delivery needs.

Alternatively, Customer B attempts to extract lower rates only for those destinations for which it believes the Postal Service is the low-cost provider among all service providers. The Postal Service may agree to this demand in order to keep the customer's business overall, which it believes will still satisfy total cost coverage for the agreement. Then, the Customer would use other providers for destinations other than those for which it extracted lower rates. This would affect the Postal Service's overall projected cost coverage for the agreement, so that it no longer would meet its cost coverage requirement. Although the Postal Service could terminate the contract when it first recognized that the mailer's practice and projected profile were at variance, the costs associated with establishing the contract, including filing it with the Postal

Regulatory Commission, would be sunk costs that would have a negative impact on the product overall.

Harm: In billing determinants and supporting documentation pertaining to domestic and international competitive NSAs, public disclosure of information contained in underlying financial analyses would be used by competitors and customers to the detriment of the Postal Service.

Hypothetical: A competing package delivery service obtains a copy of information contained in unredacted versions of financial work papers associated with particular agreements. It analyzes information contained in the work papers to determine what the Postal Service would have to charge its customers in order to comply with business or legal considerations, including meeting its minimum statutory obligations regarding cost coverage and contribution to institutional costs. It then sets its own rates for products similar to those that the Postal Service offers its customers below that threshold and markets its purported ability to beat the Postal Service on price for domestic or international delivery services. By sustaining this below-market strategy for a relatively short period of time, the competitor, or a group of the Postal Service's competitors acting in a similar fashion, freeze the Postal Service out of one or more relevant delivery markets. Even if the competing providers do not manage wholly to freeze out the Postal Service, they significantly cut into the revenue streams upon which the Postal Service relies to finance provision of universal service.

Harm: In billing determinants and supporting documentation pertaining to domestic and international competitive NSAs, public disclosure of product volume, weight, revenue distribution, and product insured-value distribution would enable competitors to assess vulnerabilities and focus sales and marketing efforts to the Postal Service's detriment.

Hypothetical: For Inbound Air Parcel Post, a competing package delivery service determines what the Postal Service would need to charge its customers (which may

include foreign postal operators) to meet its minimum statutory obligations for cost coverage and contribution to institutional costs. The competing package delivery service then sets its own rates for products similar to those the Postal Service offers other postal operators under that threshold and markets its ability to beat the Postal Service's price for inbound air parcels. By sustaining this below-market strategy for a relatively short period of time, the competitor, or a group of the Postal Service's competitors acting in a likewise fashion, freezes the Postal Service out of the inbound air parcel delivery market.

Hypothetical: For EMS and Canada Post Bilateral for Inbound Competitive Services, another postal operator sees the price and concludes that there may be some additional profit margin between the rates provided to Canada Post and the statutory cost coverage that the Postal Service must produce in order for the agreement to be added to the competitive products list. That postal operator then negotiates lower prices with the Postal Service on its own behalf or uses its knowledge to offer postal customers lower prices than they currently receive. Either or both ways, the Postal Service loses market share and contribution.

(6) The extent of protection from public disclosure deemed to be necessary;

The Postal Service maintains that the portions of the materials filed nonpublicly and relating to competitive products should be withheld from persons involved in competitive decision-making in the relevant markets for competitive delivery products (including private sector integrators and foreign postal operators), as well as their consultants and attorneys. Additionally, the Postal Service believes that actual or

potential customers of the Postal Service for these or similar products should not be provided access to the nonpublic materials.

(7) The length of time deemed necessary for the nonpublic materials to be protected from public disclosure with justification thereof; and

The Commission's regulations provide that nonpublic materials shall lose nonpublic status ten years after the date of filing with the Commission, unless the Commission or its authorized representative enters an order extending the duration of that status. 39 C.F.R. § 3007.30.

(8) Any other factors or reasons relevant to support the application.

None.

Conclusion

For the reasons discussed, the Postal Service asks that the Commission grant its application for nonpublic treatment of the Nonpublic Annex of the FY 2016 ACR.

Appendix 1 to Application for Nonpublic Treatment
List of Impacted Third Parties and Contact Information

Impacted Third Party Number	Contact Information
1	New Zealand Post Limited Mr. Lindsay Welsh, International Relations and Policy Director, International and Global Logistics +64 4 496 4574 lindsay.welsh@nzpost.co.nz
2	Hongkong Post Mr. Steve Lau, Senior Manager, International Business, External Affairs Division +852 2921 2120 steve_lau@hkpo.gov.hk
3	Deutsche Post AG Birgit Bünnigmann, Head of Direct Entry +49 228 182 21513, birgit.buennigmann@deutschepost.de Ivo Wisser, Product Manager Direct Entry +49 228 182 24105, i.wisser@deutschepost.de Guadalupe Contreras, Global Business 202-268-4598 guadalupe.n.contreras@usps.gov
4	Royal Mail Guy Fischer, Director, Overseas Contracts & Policy +44 7703104937 guy.fischer@parcelforce.co.uk
5	China Post Group Ms. Wu Yan, Deputy Manager, International Business Development China Post EMS and Logistics Corporation (China Post Group) +86 13 621 256 616 wuyan@ems.com.cn
6	BBVA Bancomer USA, Inc. Aurora Garza Hagan, CEO 281-765-1525 aurora.garza@bbvabancomerusa.com
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10	<p>Domestic Competitive NSA Customers Elizabeth A. Reed, Attorney, Pricing and Product Support 202-268-3179 elizabeth.a.reed@usps.gov</p>
11	<p>International Competitive NSA Customers Christopher Meyerson, Attorney, Global Business 202-268-7820 christopher.c.meyerson@usps.gov</p>
12	<p>FedEx Express James H. Ferguson, Corporate Vice President 901-434-8600 jhferguson1@fedex.com</p>
13	<p>Canada Post Corporation Ewa Kowalski, Director International Mail Settlement and USPS Relations 1 (613) 734-6201 ewa.kowalski@canadapost.ca</p> <p>Victor Chong Advisor, International Mail Settlement International Relations 1 (905) 214-9380 victor.chong@canadapost.ca</p>
14	<p>Correos de México Guadalupe Contreras, Global Business 202-268-4598 guadalupe.n.contreras@usps.gov</p>
15	<p>E Parcels Group Guadalupe Contreras, Global Business 202-268-4598 guadalupe.n.contreras@usps.gov</p>
16	<p>UPU Designated Operators Contact information for all UPU Designated Operators is available at: http://pls.upu.int/pls/ap/addr_public.display_addr?p_language=AN</p>
17	<p>EMS Operators List of EMS Operators is available at: http://www.ems.post/members-ems-cooperative Contact information for EMS Operators is available at: http://pls.upu.int/pls/ap/addr_public.display_addr?p_language=AN</p>

Appendix 2 to Application for Nonpublic Treatment
List of Impacted Parties by Non-Public Folder

Folder	Impacted Third Parties Identified by Party Number in Appendix 1
FY16-NP1	10
FY16-NP2	1, 2, 3, 4, 5, 7, 8, 9, 11, 12, 13, 14 ,15, 16, 17
FY16-NP3	12,13
FY16-NP4	12,13
FY16-NP5	6
FY16-NP6	12, 13
FY16-NP7	12, 13
FY16-NP8	12
FY16-NP9	12, 13
FY16-NP10	N/A
FY16-NP11	N/A
FY16-NP12	N/A
FY16-NP13	12, 13
FY16-NP14	12, 13
FY16-NP15	N/A
FY16-NP16	N/A
FY16-NP17	N/A
FY16-NP18	N/A
FY16-NP19	N/A
FY16-NP20	N/A
FY16-NP21	N/A
FY16-NP22	12, 13
FY16-NP23	13
FY16-NP24	N/A
FY16-NP25	N/A
FY16-NP26	N/A
FY16-NP27	10
FY16-NP28	12, 13
FY16-NP29	N/A

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

Eric P. Koetting

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December 29, 2016